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A DIGEST
OF THE
SECOND ENGLISH TRANSLATION
OF
**GIDE'S PRINCIPLES OF
POLITICAL ECONOMY**

BY
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PRINCIPLES OF POLITICAL ECONOMY

BOOK I. GENERAL NOTIONS

I. What is Political Economy ?

POLITICAL ECONOMY is one of the sciences known as the Social Sciences. There are many kinds of social relations, and so there are many distinct social sciences. The lines of demarcation in these sciences are not so clear as in the natural sciences. The classification is more or less artificial. Many subjects come clearly within the scope of all those social sciences which are more closely related to each other. We must only remember that the same subject can be studied from different stand-points. With these preliminary remarks, political economy may be defined as a science which considers the relations of men living in society, so far as these relations tend to satisfy the wants of life, and concern the efforts made to provide for all that is generally understood by material welfare. An attempt is sometimes made to divide the science into two branches—pure political economy and Social Economics. These sciences do not differ

in their contents. The manner of treating the subjects is different. Pure political economy (sometimes called abstract economics or simply economics) investigates those relations that arise naturally among men living together. It endeavours to explain matters as they happen to be without passing judgment on them. Social economics, on the other hand, purposes to investigate and devise means by which better conditions may be attained.

II. Are there Natural Laws in Political Economy ?

There are many who say that social sciences can at best venture conjectures which are, as often as not, discredited by actual occurrences. They consider scientific prediction in social sciences impossible.

There is a twofold error in the above argument :—

(1) We are in the habit of representing natural law as an inflexible power commanding unconditional obedience. But Natural law is really nothing more than the expression of certain relations which arise spontaneously among things or among men. These relations may be called necessary ones, but only when certain conditions are fulfilled.

(2) Free will is commonly understood to mean the power to do just as one pleases, without cause or reason. On the contrary, the conduct of every reasonable man is determined by motives, and there are always sufficient causes, known or unknown, for his actions.

Economic prophecies are often shown to be false by subsequent events. If the previsions in Political Economy are uncertain, the reason for this must not be sought in the play of free will, but simply in our ignorance of the causes at work.

III. The Formation of Economic Science

The word *economy*, or *economics*, was used by the ancients. But for them it meant only domestic economics. The designation political economy was synchronous with the establishment of the great modern states of Europe, and signified that the science had to do with the economy of the body politic or the nation.

Some of the problems of economy have attracted the attention of the ancients, but they failed to conceive the possibility of making these matters the object of a completely distinct science.

The discovery of America gave the first impetus to the development of a true economic science. The wealth of Spain was seen with envious eyes by England, France, and Italy. The sale of manufactured products abroad was believed to be a means of acquiring gold. Elaborate measures were devised, and the system known as the Mercantile System came into prominence.

A strong reaction soon followed. Foremost in people's minds seemed the desire for a return to "the state of Nature." This feeling found utterance in the general literature of the time, particularly that of France. Quesnay published his "*Tableau Économique*." A group of eminent men became his disciples and adopted the name of Physiocrats; it was then that economic science really began. The new school introduced two basic ideas :—

(1) The superiority of agriculture over commerce and industry. Classes of society other than farmers they called "sterile classes."

(2) The existence of a "natural and essential

Political Economy

order of human societies." They emphasized the necessity of letting things alone.

The first of these principles, although it brought about a fortunate reaction, was erroneous. The second served during a century as the foundation of the whole edifice of political economy.

The year 1776 saw the publication of the now well-known work of Adam Smith. His "Inquiry into the Nature and Causes of the Wealth of Nations" procured for him the title of the "father of political economy."

Adam Smith rejected the first physiocratic principle, but he confirmed and developed most brilliantly the second tenet. He was much superior to the physiocrats in observing facts and in profiting by lessons of history. Economic science has enlarged little since his time.

A short time after Adam Smith, three economists came forward. Two of these, Malthus and Ricardo, were Englishmen. The first is the author of the celebrated theory concerning the increase of population. The second is equally famous for his theory of rent. The third, J. B. Say, was a Frenchman. His "Traité d'Économie Politique" is remarkable for its clear style. Translated into all languages of Europe, this book was the first popular treatise on Political Economy.

IV. Differences of Opinion concerning Method

The Classical school of economists, especially as represented by Ricardo, preferred to employ the deductive method. This method starts from certain general data conceded to be beyond dispute, and proceeds to deduce an infinite series of propositions.

The new school, called Historical or Realistic,

recommends the inductive method. It starts from the observation of certain definite facts and bases its general propositions upon these observed facts. In the field of economics this method consists in the patient and accumulated observation of all social facts as they are revealed to us. This school does not attempt to discover general laws governing abstract men, but historical laws governing the relations among men living in a given nation at a given epoch. For this reason the name "National" is sometimes applied to this school of political economy.

This method is safer than the other, since it abstains from all sweeping generalizations, but it is less fruitful. There are two reasons for this :—

(1) The observation of economic and social facts is a task far beyond the capacities of any single person.

(2) The mere observation of facts without experiment would never have given the marvellous results obtained in the natural sciences, and in social sciences experiments are almost impossible. The economist cannot make pre-arranged experiments ; he is obliged to wait for experiments to take place of their own accord. Again, he is obliged to study facts as they happen to occur, without being able to isolate any one of them from the mass of other facts with which it is interwoven.

After all, the new school employs the same categories of thought as the old school. It has not remade economic science ; it has only introduced into it a new spirit. In its turn, this school has given rise to much criticism, inasmuch as, by dint of devoting its attention to the observation of facts, it incurs the risk of remaining purely descriptive.

We cannot reject absolutely the abstract method. The proper procedure has three stages :

(1) Observing facts without any preconceived notion.

(2) Imagining a general explanation in other words, formulating a hypothesis.

(3) Verifying this hypothesis by experiments, if possible, or by special observation. This is the method employed in natural sciences. The mistake of the classical school did not consist in making frequent use of the abstract method, but in mistaking the abstraction for the reality. The deductive method is revived by two new schools of economic thought.

The first of these is the Mathematical school. This school regards the social economic forces as susceptible of being expressed by algebraic factors. For by doing so it reduces a problem to a certain limited number of factors, excluding all others.

The second or Psychological school, called also the Austrian school, devotes its attention almost exclusively to the theory of value. Value, according to this school, is only the expression of human desire. Economic science is thus reduced to a study of the causes which affect the human desires. It tends to become a subtle psychological analysis. In fact, the classical principle of seeking a maximum of gratification at a minimum cost is nothing less than a psychological principle.

These two schools carry the deductive method to its logical consequence, but they differ from the old school in considering their abstractions as nothing more than hypotheses necessary for the establishment of a science.

Say's naturalistic method may be said to live again in the Biologico-Sociological school which

considers political economy as a kind of annexe to Natural History and Biology. This school has now lost much of its influence.

V. The Various Economic Schools of Thought

SECTION I. THE LIBERAL SCHOOL

This school has derived its name from its celebrated motto, *Laissez faire, Laissez passer*. The beginnings of this school coincided with the origin of economic science. Its partisans have assumed the simple name of "economists." Its doctrines may be summed up in three points :—

(1) Societies are governed by natural laws which we could not alter. As these laws are good we have not the least interest in modifying them, even if we could. The economist has only to discover these laws.

(2) These laws arise spontaneously wherever men are free to act according to their own interests. They establish a sort of harmony among individual interests which is superior to any artificial arrangement that could be devised.

(3) The part of the legislator must therefore be limited to developing individual initiative as far as possible. The intervention of governments should be reduced to the indispensable minimum.

This conception lacks neither simplicity nor grandeur. Whatever may be its future, it has at least helped to establish a science of political economy, and it will serve as a foundation for new theories.

There are, however, serious drawbacks in it. The school shows a marked tendency to optimism, inspired by a desire to justify the existing order of

things. No doubt the very fact of the existence and duration of the institutions of a society shows that they have a value ; but it is illogical to conclude therefore that they are best.

The idea that the prevailing economic order is the product of liberty, and that it could be replaced only by an order founded on constraint and therefore worse than the present one, is not well conceived.

It is not legitimate to conclude that, because natural laws are permanent and immutable, existing economic facts and institutions should also possess these characteristics.

SECTION 2. THE SOCIALIST SCHOOL

The Socialist school is as old as the classical school. The doctrines of this school are especially of a critical nature. They may be summed up as follows : All sects of socialists believe that the organization of modern societies is tainted by certain deep-rooted defects, and that the present social organization is therefore bound to disappear sooner or later. In their opinion, this organization is the result of many acts of injustice. They maintain that the source of these evils lies in free competition and in private property, which tend to increase the wealth of a small number by multiplying the number of the poor.

They prophesy a new order of things in which private property will be continually reduced. They are divided into three classes :—

(1) The Communists, who favour the entire suppression of private property.

(2) The Collectivists, who favour the suppression of property in the instruments of production.

(3) The Nationalists, who favour the suppression of property in land and buildings.

As for the details of the future society there is much disagreement and doubt. The old socialists (More, St. Simon, Fourier), who are disdainfully called Utopian, attempted to build up a complete social structure based on an *a priori* conception of Justice. Karl Marx, Lassalle, and others who assume the title of Scientific Socialists, assert that the future society will issue forth from the present society. They refuse to describe its features but claim to see the society of the future in an embryonic state in the womb of our modern societies.

The assertion of the classical school that the socialists deny the existence of natural laws is not true. The classical school associates the idea of stability with the term *natural law*, while the socialists employ the same term as implying the idea of change. All these schools (save the Anarchist school, which is violently individualistic) are disposed to extend the functions of the Government. Their aim is to support private enterprises by public agencies.

The criticisms of the socialists contain a large share of truth and have exerted a salutary influence, but as a positive doctrine socialism remains conjectural. The ideal future State would seem neither realizable nor desirable.

SECTION 3. STATE SOCIALISM

This doctrine should not be confounded with the preceding one. It represents an antidote for Social Democracy, and is popular with established Governments. It is closely connected in its origin with

the Historical school. The Historical school was first distinguished from the classical in point of method, but it soon came to differ from it in its tendency and practical programme. It rejected the principle of *Laissez faire* and gave a practical aim to political economy. It regarded the old separation of Art and Science as antiquated at least in the social sciences. It maintains that we cannot completely transform economic institutions, but with due regard to history we can modify them. It attaches little importance to Natural Laws but much to Positive Laws, and favours a considerable extension of the functions of the State.

This has exerted a wide influence in recent years. The Labour Laws, as well as the strong movement in favour of an international regulation of the conditions affecting labour, are largely due to the influence of this school. It has done a great service in abandoning the attitude of systematic abstention from all practical matters. It considers the State a very active factor of social progress.

The great objection to State socialism is that it can bring about reform only by means of laws, *i.e.*, by means of constraint. It may be said in reply that the State does not always act by means of coercion. It very often acts by way of example or by way of assistance. Another objection is that the State has shown deplorable incapacity in economic matters. But these defects are due less to the essential nature of the State than to its present organization. It is reasonable to hope that when the State is constituted with a view to its economic functions (and not solely for political functions), it will be able to exert a better and stronger influence in the economic domain.

SECTION 4. THE CHRISTIAN SOCIAL REFORM

This school may be divided into two branches corresponding to the two great divisions of the Christian Church.

(1) The Catholic school believes in the existence of natural laws, which it terms Laws of Providence. It believes that the operation of these laws may be, and is, seriously interfered with by the evil use of liberty. The vehemence of the criticism of this school against the present social organization, against capital, against profit, against interest, &c., has procured it the name of Catholic socialism, to which it strongly objects. It does not propose to abolish the fundamental institutions of the present social order. Instead of seeking its ideal in the future, it recommends a return to the institutions of the past, such as rural life and the trade guilds. It advocates three kinds of authority: that of the father in the family; that of the employer in the workshop; that of the Church in society as a whole.

This school is not hostile to State intervention, but one section of the Catholic school is opposed to it.

(2) The Protestant school, like the Catholic, has little sympathy with the present economic order. It does not attempt a solution by means of Guilds, but by Co-operation. As for State intervention, it is difficult to discover among Protestants any general programme concerning this point.

SECTION 5. THE DOCTRINE OF SOLIDARITY

The fact of solidarity, *i.e.*, the mutual dependence of mankind, did not escape the attention of the

classical economists. The school of Solidarity conceives solidarity as the desirable result toward which we should bend our will. It endeavours to substitute co-operation for competition. It does not believe in the efficacy of revolution or expropriation as a means for transforming man; it works, however, for the realization of the principal desiderata of socialism. As means to these ends it advocates association in all its forms. It is not hostile to State intervention whenever legislation tends to prevent the degradation of the masses. It regards the State as the oldest and most impressive form of solidarity and considers that the solidarity imposed by Law prepares the way for the fuller development of free co-operation. This doctrine has succeeded in attracting adherents from all classes, but its popularity is perhaps due to the fact that its programme is quite indeterminate.

VI. The Wants of Man

Human wants have several characteristics :—

(1) They are unlimited in number. This feature is the mainspring of civilization. To civilize a people is to increase its wants. Nations are doomed if they are too easily satisfied. But is this unlimited multiplication of wants commendable? With the satisfaction of every want another takes its place, therefore our best course will be to replace these wants by nobler ones. If we give them up without filling their place, that will mean the retrogression of social life toward the animal state.

(2) Wants are limited in intensity. This proposition is very clear. A want decreases in intensity up to the point of satiety when it is extinguished and replaced by disgust or suffering. It is torture to

suffer thirst, but it is also torture to be compelled to absorb an excessive quantity of water.

(3) Wants are competitive. One want can often be developed only at the expense of other wants. Progress consists in replacing inferior wants by higher ones.

(4) Wants are complementary, they form groups. The want of food is allied, in some civilised societies, with the want of tables, chairs, table-cloths, knives, forks, &c.

(5) Wants, even acquired or artificial wants, tend to become a matter of habit. They become our second nature.

VII. What is Wealth?

In ordinary speech the word *wealth* is synonymous with the word *fortune*. It seems therefore strange to apply the term *wealth* to a loaf of bread. Yet this is perfectly correct if we mean by *wealth* all that can satisfy human wants. The capacity for satisfying human wants is called *utility*. Utility depends first on a want felt by man, and secondly, on an object capable of satisfying that want. Of these two features of utility, man, not the object, is more useful. Utility arises only with desire and vanishes with the extinction of desire. It is subjective, not objective. It matters little that an object has qualities that may satisfy the wants of man, if man is not aware of the fact. The falls of Niagara did not represent economic wealth until men learned how to utilize their motive power. On the contrary, it matters little that an object has not the qualities for the satisfaction of human wants, if only we think that it possess them. There are patent

medicines that command high prices although their curative powers are doubtful. Alcoholic drinks do not possess any of the good qualities attributed to them, but millions believe that they do possess these qualities ; they therefore constitute wealth. Hence wealth may be defined as all that mankind believes to be useful and can utilize.

Many economists affirm that the term wealth implies material goods—for wealth is that which can be weighed, measured, and accumulated.

In reply it must be said that persons are of course not things, and cannot be regarded as wealth. But why should not their acts be regarded as wealth? Are they not useful? Are they not paid for? After all, it is a question of terminology. The word wealth may be reserved for corporeal objects, and all the acts of men that are capable of furnishing enjoyment or utility may be designated services.

VIII. What is Value?

Value and wealth both involve the idea of utility. But these two words do not express quite the same idea. Sometimes they may imply even contrary ideas. The idea of wealth implies abundance. The idea of value, on the other hand, is most closely allied with that of scarcity. Suppose that all objects are as abundant as the water of the rivers : would not this be the maximum of wealth? Yet is it not evident that these things would have lost all value because of their superabundance?

The idea of value implies the thought of exchange. Health is wealth and would certainly possess great value if it could be purchased. A fine system of navigable rivers represents great

wealth but no value. Robinson Crusoe had accumulated great wealth on his lonely island, but it had no value.

The most essential characteristic of value is the idea of a relation between two desires or wants. In other words, value implies a comparison of desires. Wealth or Utility may exist of themselves, but Value is a relative notion. Why do we attach value to an object? We may value things because of the pleasure they give us, or we may value them because of the effort, the trouble, or the pain involved in their acquisition. These are the two inseparable ideas which underlie the concept of value. Economists have usually placed all the emphasis on one of them and minimized the significance of the other. The innumerable theories of value may be classified under these ideas. The element of pleasure is foremost in those theories which found value on utility, while the element of pain is emphasized by the theories based on cost or labour.

SECTION I. UTILITY

Utility is the characteristic of wealth. The physiocrats therefore regard it as the cause of value. When two objects satisfy the same want, this explanation is satisfactory. Of two houses we prefer the more comfortable, of two farms the more fertile. But if we consider objects satisfying different wants—for instance, a loaf of bread and a hat—this theory fails to tell which is the more useful.

It may be suggested that we should classify our wants according to reason. Shall we then put at the head of the list those objects that satisfy

the most essential wants? A glance at such a list would show that the value of a commodity is not directly proportionate, but often inversely proportionate to its rational utility. It could not be objected that this condition of things is due to man's foolishness; the theory of value should explain that which is, not that which ought to be. Moreover the objection is not valid. Even if the earth were inhabited only by wise men, a glass of water would not be worth more than it is now. Again, there are many uses for one and the same object. We must therefore ask if utility determines value. What is utility?

To escape this difficulty an attempt has been made to supplement the notion of utility by that of scarcity. Value in this sense means scarce-utility. The idea of scarcity is insufficient. It is difficult to understand the close relation between these two elements—utility and scarcity—that seem to have nothing in common.

A more recent school claims the merit of having discovered the tie that binds these two ideas. It propounds the theory of final utility. Only it has demonstrated that scarcity—*i.e.*, limitation in quantity—far from being independent of utility, is really inseparable from it.

In basing value on a single principle, this theory does not seem to have succeeded any better than preceding theories.

SECTION 2. LABOUR.

The second theory is the inverse of the first. While the first clings to the idea of gratification afforded by goods, the second emphasizes that of the effort made to get them. First developed by

Adam Smith, it has been accepted by economists belonging to many different schools. This school does not deny that utility is the fundamental condition of value, but claims that the basis of value is human labour ; utility is the condition of value, but not the cause.

This theory seems to possess two advantages over the preceding one :—

(1) That of being more scientific, because it gives as the basis of value something that can be measured. To say that a certain watch has twice the value of another because it represents twice as much labour satisfies our mind.

(2) Since it gives as the basis of value a human element—labour—it satisfies better the idea of justice.

Yet the explanation is unsatisfactory, for the following reasons :—

(1) If the essence of the value of a thing consisted in the labour requisite for its production, then value would necessarily be unchangeable, for past labour is not susceptible either of a more or less. It may be said in reply that we must consider, not past labour but present labour. But there are other objections more difficult to remove.

(2) If labour were the cause of value, equal labours would always correspond to equal values. But we see objects that have cost the same amount of labour selling at different prices. On the other hand, objects which have cost different amounts of labour are sold at the same price.

(3) If labour were the cause of value, value would be absent where labour is absent. But there are numerous things which have value of their own without the intervention of labour, *e.g.*, springs of petroleum. There are also things which acquire

additional value without any additional labour, *e.g.*, wine that has been stored in wine-cellars.

(4) Above all, if labour is the cause of value, what is the cause of the value of labour itself? Undoubtedly labour is bought and sold, or rather is hired every day at a certain price. To pretend to explain this is to reason in a circle.

The real explanation lies in the adoption of both these theories of value. We may place a value upon things because they afford us pleasure, or we may do so because they have cost us some expenditure of effort or pains.

IX. What is Price?

To obtain a definite idea of the value of things, it is not sufficient to compare them with one another. A common measure is necessary. Such a measure enables us to compare two things in different places, or the same thing at different times. In order to measure value we must take the value of a definite object as a basis of comparison. Each nation and every period seems to have had its own measure of value. Almost all civilized people have agreed in choosing as their standard the value of the precious metals, especially gold and silver. To compare the value of any object, they compare it with the value of a particular weight of gold or silver, which serves as the monetary unit. The price of a thing therefore is its value expressed in money.

The precious metals have been chosen as the common measure of values because they possess two properties that enable them to fulfil the function admirably :—

(1) Great value in small bulk, which makes them very easily transportable.

(2) Almost unlimited durability.

By virtue of the first property, the value of the precious metals is that which varies least from one place to another ; by virtue of the second property, it varies least from one year to another. This double invariability is the essential quality of every good measure. But when we take very long periods into consideration, this measure is found to be defective. Various substitutes—such as wheat, labour, the wages of a workman of the lowest class—are proposed, but they hardly deserve serious consideration. In the absence of something better, we must rest satisfied with gold and silver.

BOOK II. PRODUCTION

PART I. THE FACTORS OF PRODUCTION

A THREEFOLD division of the agents of production into Land, Labour, and Capital has been handed down from the time of the first economists. Classical political economy has shown a tendency to regard these factors as equally important. Such an effort is unscientific. Of the three, labour only can claim to be an agent of production in the strict sense of the word. Only man plays an active part in production. Nature is absolutely passive, yet it is indispensable to production. It must exist before labour. The third factor, capital, also plays a purely passive part. It is not even a primary factor of production. It is derived from the other two. Its right name is *instrument* of production.

CHAPTER I—LABOUR

I. On the Part Played by Labour in Production

PEOPLE seldom realize what an important part labour plays even in those products that are often inaccurately termed *natural*. They are ready to believe that everything that grows on the earth is due to the generosity of Nature. As a matter of fact nearly all the plants which supply man with food have been modified by cultivation and by the labour of hundreds of generations.

It is true, however, that some wealth is not the product of labour, precisely because it exists before any act of production, *e.g.*, soil and all the substances with which it supplies us. Even in this labour plays some part. We must bear in mind two points :—

(1) This natural wealth does not exist as wealth, *i.e.*, as useful and valuable objects, until human intelligence has been able to discover its existence and to perceive that it can satisfy our want.

(2) Natural wealth cannot be utilized until it has undergone a certain amount of labour. Virgin soil must be cleared of its trees and underbrush, before we can use it.

II. How Labour Produces

We must distinguish three varieties of labour :—

(1) Manual labour. This is nothing more than muscular energy directed by intelligence. It can

produce only a movement or a change of place. This movement may be a displacement of the object or of its component parts. In the latter case we say that there is a change of form, but every change of form is really only a displacement. The exquisite shapes assumed by clay under the hand of a potter are only the effects of the arrangement or displacement of molecules of clay. All that man's labour can do is to stir, separate, connect, insert, superpose, and arrange. All these are only different kinds of motions. Analyse any industry and no other factor can be found.

(2) All physical labour must be preceded by purely intellectual labour which we may call Invention. Industry has converted the apparently worthless residue of coal into perfumes or dyes. The list of our riches is every day being lengthened with the advance of science. Invention does not mean, as might be believed, the rare idea that springs from the mind of a man of genius ; it is a requisite of every productive act. There is no movement of the arms or fingers in any productive act that was not invented by some one.

(3) Finally, it must be remembered that all collective labour requires direction or supervision. Each labourer in a productive enterprise must be told what to do according to a general plan. This planning or directing is in itself a very effective kind of labour, the importance of which increases as production is conducted on an increasingly large scale.

III. The Evolution of Ideas concerning the Productivity of Labour

The title of *productives*, originally applied only to one kind of labour, has gradually been extended in its application.

(1) The physiocrats confined the epithet *productive* to agricultural labour and denied it to all other labour. According to them agricultural and similar other labours furnish all the materials for wealth, while other occupations only work them up.

(2) The definition of the physiocrats was too narrow. The raw product of agriculture and mining is usually unfit for consumption ; it must undergo numerous modifications which are effected by manufacturing industries.

It is an error to say that agriculture and mining create wealth, and that manufacture or industry only transforms it. The farmer creates nothing ; he, too, simply transforms the elements contained in the soil and air.

Ever since Adam Smith wrote on this subject no one has hesitated to regard manufacturing as productive labour.

(3) With regard to the labour of transportation there has been more hesitation, because it seems to make no change whatever in the article transported. This feature of identity, it was urged, distinguishes transportation from manufacturing.

If we decide that displacement is not essential enough a modification to entitle it to be called productive, then we cannot call mining productive either. What distinction is there between the work of a miner and that of the wagoner unless we pretend that displacement is productive only when it takes place vertically and not so when it takes place horizontally?

(4) With regard to Commerce or Trade, the hesitation has been even longer. It may be said that commerce or trade, *i.e.*, buying for the purpose of selling, does not imply any creation of wealth.

We must observe that commerce cannot very well

be separated from transportation. Merchants are the real directors of transportation ; the carrying industries only do their bidding. Moreover, they also preserve and store up goods, and sometimes even subject them to slight modifications. Even when commerce is nothing more than exchange pure and simple, the mere act of transferring a thing to the person who will utilize it must be regarded as productive.

(5) Finally, discussion has been keenest with regard to services, such as those rendered by the liberal professions. It may be asked, Where are the products of the labour of a judge or of a surgeon? Two facts must be noted in this connection :
(a) Production has for its direct object the satisfaction of human wants, and some wants may be satisfied without the intervention of material objects.
(b) Owing to division of labour, there is such an interdependence in the labours of men that even immaterial services are an indispensable condition of the production of all material wealth. Undoubtedly the various kinds of labour do not contribute in just the same way to production. It is not even necessary to determine which of these labours is most useful economically. What we need is a proper co-ordination of the various functions and labours.

IV. Pain as a Factor of Labour

All productive labour involves toil. If men worked only for pleasure, it would no longer be necessary to have private property or a stimulus to toil. Fourier the socialist understood this. He proposed to make all sorts of work just so many kinds of sport. There is really nothing absurd

about this ; but it must be observed that there is a great difference between work done solely for pleasure and work done for the purpose of earning a livelihood. King Louis XVI. found amusement in making locks ; a man who has to support himself and his family by making locks surely cannot appreciate the amusement. In order to induce men to work, some kind of motive is needed. When work was done by slaves the whip furnished the incentive. For the altruist of the future, the sense of a social duty will perhaps be sufficient. But for the man of to-day, as a general rule, the motive is self-interest. Wants supply a sort of stimulus. If in addition to the stimulus of present wants there is also that of future wants, productive activity is greatly increased ; but foresight belongs only to civilized races.

V. Time as a Factor of Labour

All labour not only involves a certain amount of displeasure, but also requires a certain amount of time. As a general rule, the time of waiting is proportionate to the productivity of the enterprise. The element of time—an indispensable factor in all productive enterprises—is one of the principal reasons for the importance of capital and the privileged position of those who happen to own it.

We must note that man has only a limited amount of time at his disposal, not only because life is short, but also because many deductions must be made from a man's time. Man cannot work every hour of the day, nor can he work all the days of the year. There is no country in which there are no holidays. Again, it is impossible for man to work all the years of his life ; he must deduct the years of infancy and also the years of old age.

CHAPTER II—NATURE

NATURE signifies the sum total of those elements and productive forces which are furnished by our natural environment. Before we produce anything we must have a favourable environment—land and raw material, climatic conditions, geographical configuration, and geological nature constitute the environment of man. Much of the industrial advance and commercial success of a country depend on the favourable character of this environment.

Land is another gift of Nature. With the growth of population there is an increasing demand for land. It would be absurd to fear that some day there will not be room enough for all men, yet it is not unreasonable to ask whether there will always be space enough to supply food.

As for raw materials, Nature has spread some about with lavish profusion, while others she has given but sparingly. Even those that exist in large quantities may be scarce in certain regions. Some of these materials that are superabundant and unequally distributed may be transported by human ingenuity to places where they are lacking. It is for this reason that transportation must be regarded as an act of production.

The Law of Diminishing Returns

As land and raw materials are limited in quantity, the productions in which they are the necessary

factors also must be limited. This applies with particular force to industries such as hunting and fishing. Yet these occupations may be changed from simply extractive industries into productive ones like agriculture, in which we do not merely let Nature work, but assist and guide her. Even in agriculture there are two important limitations:—

(1) Agricultural production is limited by the supply of mineral substances that are indispensable to plant-life. A part of these substances is removed with every crop that is raised on the land. It is true that the farmer aims at enriching the soil by adding new substances to it, but the sources of these substances are themselves limited.

(2) Agricultural production is limited by the time and space necessary for vegetable and animal life. The farmer is reduced to an almost passive part in production; he must wait for Nature to accomplish her part of the work. Again, the space required by every plant to spread its roots and to breathe cannot be restricted.

Doubtless the farmer can increase the yield of every piece of land, but after a certain point he can only do so at an increased cost in labour. Suppose twenty days' labour is necessary to produce forty bushels of wheat from an acre of land. To double the product it would be necessary to treble, perhaps to quadruple, the labour and expense. This fact is expressed by the Law of Diminishing Returns, according to which the returns are not directly proportionate to the increased expenditure of labour and capital.

Motive Forces

There are really four or five Motive Forces which man has been able to utilize in production. The

muscular energy of animals, the propelling power of wind and of water, the expansive power of vapours and, recently, electricity—man makes use of these Natural Forces by means of machinery. There are other forces which we have not learned to utilize. The waves of the sea and the rising tide really constitute inexhaustible stores of motive power. Unfortunately, these forces of Nature seem too savage to be controlled. Very lately it has been suggested to draw from the sun all the heat we require.

The Illusions to which Machinery has given rise

Ambitious hopes have been aroused by the marvellous effects of the use of Machinery propelled by the forces of Nature. According to a socialistic calculation, one hour and twenty minutes per day would suffice to produce more wealth than is necessary to satisfy all our wants. There is no doubt that machinery has multiplied each workman's productive power at least ten times ; or we may say that each of them has ten slaves at his service. As a consequence of this new slavery it is to be hoped that men of the future will be able to lead the noble life of the ancient Greeks or of the Romans. This is indeed an alluring prospect, but a closer analysis dissipates the illusion. Such a social state may not even be desirable. Antique slavery was no less harmful to the masters than to the slaves. We have no reason to hope that modern slavery will have different effects.

Again, these hopes are greatly exaggerated. The first requisite of welfare is food. Yet this is precisely the province in which machinery has thus far made but little advance. Machinery is applicable only to a limited extent in the construction of houses.

In manufacturing, machinery has exceeded our hopes. It produces not only great cheapness but superabundance. Finally, we must blame machinery for the crises produced by overproduction of goods and for the constant failure of many workers to find employment.

Political economists have generally pointed out the following advantages of machinery :—

- (1) It diminishes the strain on human muscles.
- (2) It permits the employment of workers of average strength and skill for tasks that formerly required an exceptional degree of both.
- (3) It performs work much more rapidly.
- (4) It excels both in the performance of exceedingly great tasks and in the accomplishment of exceptionally delicate ones.
- (5) It performs the monotonous work and lessens the monotony of life.
- (6) It permits the production of a large number of exactly identical pieces or products.
- (7) It weakens the barrier between different trades.

Whether Machinery is Detrimental to the Working Classes

The classical economists sought to prove that in our economic organization there could be no conflict between the interests of the society and those of the individual. They endeavoured to show that machinery does more good than harm to the working classes. The three classical arguments are the following :—

- (1) *Machinery lowers prices.* By the fall in prices the workman gains an advantage as consumer that is equivalent to his loss as producer.

To this argument we must reply that the compensation in reduced prices will not exist if the product in question is not consumed by the worker.

Even when it is consumed by the worker, it may form so small a part of his expenditure that the fall in price is only an insignificant saving.

Again, the supposed compensation is not real unless mechanical progress *take place simultaneously in all branches of production*. In fact, mechanical inventions affect but slightly the cost of the important necessities of a workman.

(2) *The increase of production*. The optimists claim that lower prices must involve larger sales and increased production. Thus the final result is to give new employment to the workmen. Instead of taking work from them, inventions make work for them.

To this we must answer, first of all, that this is by no means always the case. (a) Some wants are limited. The example of coffins has become classical. Moreover, there are articles of luxury which would be less in demand if their prices should fall considerably. (b) Whenever one industry is bound up with another a fall in price has little effect on the amount sold. No matter how low the prices of wine bottles may fall, no more of them will be sold if there is no more wine to put in them.

Even admitting an increase in consumption proportionate to the fall in prices, it will take a long time before this increase is effected. Manufacturers are not eager to lower prices. Competition will cause them to fall, but rival establishments are not built in a day. Perhaps his grandchildren will profit by the change of conditions, but for the workman without employment there is very little consolation.

(3) *Economy of labour*. The use of machinery

that economizes manual labour involves, it is maintained, a gain for some one. The money that was previously paid to the workmen who are now without work is either in the pockets of the employers or of the consumers, and it will be invested or spent. In either case the money will encourage industry. Bastiat's argument that every mechanical invention sets free a certain amount of labour and capital, and that these two elements will end by combining, is valid from an abstract point of view ; but we must ask, Where and when will this combination of labour and capital be effected? Perhaps in ten years ; perhaps at the other end of the world. Capital is readily transportable. Unfortunately, the workman cannot so easily be moved. The natural effect of a permanent army of unemployed workmen weighs on the market and lowers the wages of labour. In a word all mechanical progress can have no other effect than to render a certain amount of labour useless.

Must we therefore, like Ruskin, preach to men the abandonment of machinery? It is clear that such advice would not be followed. Again, there are reasons for believing that the great economic and mechanical transformation witnessed by the nineteenth century is drawing to a close, and that our grandchildren will not be troubled by the same social upheavals as have recently occurred.

CHAPTER III—CAPITAL

I. The Two Concepts of Capital

ALL theories of Capital may be brought under two heads, representing two great opposite tendencies. The first is that of the classical economists, the second that of the socialists.

(a) Numerous authors have invented stories of the Robinson Crusoe type with a view to showing us how man originally grappled unaided with the difficulties of existence, but not one of these authors has failed to provide his hero with a few tools or provisions. Even this romantic figure could not do without capital. But it is unnecessary to imagine the situation of a Robinson Crusoe in order to be convinced of the utility of capital. The same state of things prevails in actual every-day society. There is no problem more difficult to solve than how to acquire something when one possesses nothing. Take a common labourer. He would be as sure to die of starvation as a Crusoe who had saved nothing from the wreck, were it not for the wage-system. Animals doubtless depend on their labour and on Nature to obtain food. Primitive man was necessarily in the same situation. At some time or other, man, worse off than Robinson on his island, must have solved the difficult problem of producing the first wealth without the help of any pre-existing wealth. Once started, the most difficult step was

taken. Our modern societies, living on the wealth stored up by a thousand generations, find it easy to increase all kinds of wealth ; yet they should not forget how slow and perilous this process of accumulation must have been. (b) The second explanation of capital, given by the socialists, especially by Karl Marx, may be summarized as follows :—

Capital is not simply any instrument of production, but all wealth which serves to provide its possessor with an income independent of his labour. This definition evidently presupposes that wealth may be lent at interest or may be employed to give work to people who are glad to hire themselves out for wages. Now, this particular social organization does not exist everywhere. It is of quite recent origin. The socialists find the comparison of capital to the bow and arrow of the primitive savage simply ridiculous, since he could not have obtained an income with them without the intervention of his labour. The violent opposition between these two theories is largely due to the fact that efforts have been made to use them as weapons of social warfare. Yet there is no necessary contradiction between them. Each of them contains part of the truth. Classical economists regard capital in its natural and permanent characteristic, while the socialists consider its acquired and relative nature. The first definition emphasizes those features of capital that are essential and necessary, while the second points out only its accidental and ephemeral characteristics. The fact that no wealth can be produced without the help of pre-existing wealth is an economic law whose importance cannot be exaggerated. This pre-existing wealth whose function is so well defined is generally known as *capital*.

II. The Distinction between Wealth which is Capital and Wealth which is not Capital.

All Wealth must be applied in one of two ways : either to serve for consumption or to serve for production. Wealth serves for consumption when it is used to satisfy some of our wants. This category of wealth is not the largest. There are other kinds of wealth incapable of being used directly to provide gratification. Such wealth is used in the production of consumable wealth. It consists partly of instruments and goods altogether unfit for consumption, partly of raw material which can be consumed only after having undergone certain transformations. To this whole group we apply the name *capital*. We must not believe that it is possible to classify all commodities under one or the other of these divisions by reason of specific qualities inherent in each commodity. Any object having value may become capital provided certain conditions are fulfilled. The idea of capital does not connote a certain class or kind of goods, but a certain condition or purpose of goods. The feature, condition, or purpose that makes wealth capital is its productive use in conjunction with labour. A diamond in the hands of a jeweller and a clown's costume in the hands of a theatrical director, are alike capital, because they are instruments of production. It should be noted that some kinds of wealth even when not used productively, but for consumption, may bring an income to their owner—for example, money lent to a spendthrift. Wealth in this case also is capital, but as it is not in the service of labour it produces nothing of itself. Such capital as this we shall call *lucrative capital*.

To sum up, then, there are three kinds of wealth :—

(1) That which serves only for consumption and which is not capital, although, at any time, it may become capital.

(2) That which serves only for consumption, but which gives its owner an income derived from the incomes of others. This we call *lucrative capital*.

(3) That which is actually employed in production and which we shall therefore term *productive capital*.

III. What is Meant by “Productivity” of Capital?

It is customary to say that capital yields an income. This seems to be an essential part of its nature just as trees bear fruits. The income provided by capital is regarded as a product due exclusively to capital. This mysterious productive power is a pure chimera. Notwithstanding the popular belief to the contrary, money does not produce money. Capital is inert matter and by itself is sterile, but when it is put in the service of labour it gives labour a degree of productivity, that may be very great. What leads us astray is the fact that we see many persons living on their income without working. In reality this income is the product of labour, the labour of those who borrowed the capital and employed it productively. It is, however, possible that the capital in the hands of the borrower has been dissipated. In this case the interest received by the lender does not represent the product of the borrower's labour, but the labour of some other person.

IV. The Durability of Fixed and Circulating Capital

Capital which can be used only once, because it is consumed in the act of production, is called *circulating capital*; examples of this kind of capital are: the wheat that is sown, the manure that is mixed with the soil, the coal that is burned. Capital that can be used to serve for several productive acts is called *fixed capital*; it may include the most fragile instruments, such as needles, and the most durable kinds of wealth, such as canals and tunnels.

Whenever it can be done, there is great advantage in employing capital of long durability. However slight the labour economized every year, a time will ultimately be reached when the capital is redeemed, and the labour subsequently economized will be a net gain to the society.

Three points, however, should not be overlooked:—

(1) The formation of very durable capital generally requires an amount of labour proportionate to the increased durability. A certain equilibrium must therefore be sought between the labour-cost of the capital and its durability.

(2) The formation of fixed capital demands the present and immediate sacrifice of a large amount of labour and other commodities, while the remuneration anticipated is more or less distant. The return for capital, moreover, is all the more distant when it is of great durability. The construction of a canal such as the Panama Canal requires an immediate expenditure of a large sum, while for the remuneration we must wait half a century. Now, for such comparisons, considerable foresight and firm faith in the future are needed. Even under the most favourable circumstances the

faculty of foresight is limited. An individual or a company would not consent to advance capital which will not be paid back for two centuries. Generally capital that is not repaid in the course of a generation is regarded as poorly invested.

(3) It must finally be pointed out that mere material durability of capital is not nearly so important as the period of its utility. We can generally tell how long a tunnel will last, but we do not know how long traffic may be expected to continue taking the route that leads through the tunnel. Utility is unstable, therefore the creation of too durable capital must be regarded as ill-advised.

V. How Capital is Formed

Capital, like every other product, can only arise from the two original factors of production—Labour and Nature. An attempt has been made to base the formation of capital on a new agent called *saving*. Labour and the forces of Nature are the only conceivable creators of wealth. Some have maintained that saving is a form of labour. But to labour is to act; to save is to abstain, and it is hard to conceive how a purely negative act could *produce* anything.

This strange idea must have been occasioned by the use of money. A man who puts aside a handful of coins in a safe certainly does not create either wealth or capital. No doubt he puts aside for future use a certain amount of wealth, quite as real as though he produced it by his own labour, but this is a purely individual point of view from which to consider saving.

Saving plays an important part in consumption, but we do not perceive what it has to do with production. It should be studied in its proper place.

PART II. THE METHODS OF PRODUCTION

CHAPTER I—THE ORGANIZATION OF PRODUCTION

I. The Stages of Industrial Evolution

THE Historical school may claim the credit of having outlined the successive types of industrial evolution. It is customary to distinguish five periods :—

(1) *The home economy or family economy.* Under this system people are divided into small groups. Each group suffices unto itself ; exchange and division of labour exist only in an embryonic form. Each group consists of a family, and slaves or serfs are regarded as belonging to it.

(2) *Corporative economy or the Guild system.* This system makes its appearance in the Middle Ages, and is characterized by the separation of trades. The worker generally owns the raw materials and tools and has become what is called an artisan. He works only to order or for the small local market. He is associated with other workmen of the same trade in a kind of league for mutual defence.

(3) *Domestic economy.* The workmen in the Guilds, little by little, lose their independence. They produce for a wholesale dealer. They work at home and sometimes own their tools and raw materials. But the little town market has given

way to the national market, and the workers are too poor to obtain control of the new market.

(4) *Organized manufacture, or the workshop economy.* The intermediary now brings his dispersed workmen together in one place. Thus he gains several advantages, principally that of an extensive division of labour. Henceforth the worker has become an employee, while the intermediary who possesses tools and raw materials has become an employer. This transformation began to take place about the sixteenth century. In France the intervention of the Government was necessary to accomplish the change. In England the destruction of the Guild was brought about by the increasing exportation of goods to foreign countries.

(5) *Machine industry, or the factory system.* This is the system which marks our own epoch. It began with the application of steam to industry and transportation. As it requires constantly increasing amounts of capital, it perpetuates what the socialists call the régime of capitalism. Among its objectionable features are: the frequency of accidents, the involuntary idleness of a large number of labourers, over-production and the crises it involves, the creation of colossal fortunes and of a famished labouring-class often forced to sell its labour for a crust of bread.

It is a mistake to suppose that each of the economic systems did away entirely with its predecessors. We can only say that each of them in turn predominated. Domestic economy has especially survived, and tends once more to gain ground. This strange revival of a former industrial system is due to the recent intervention of the legislative authorities. As the Labour Laws apply especially to factories, many industries find that by having the

work done in the homes of the labourers they can easily escape legal surveillance.

We might be disposed to believe that the workman is happier by this change. Experience, however, proves that the worst exploitation takes place by this method, to which the name of *sweating system* has been aptly given. In this form of industrial organization the workman is not only robbed of the protection of the laws, but he is also entirely in the control of the intermediaries. He is, moreover, constantly exposed to the imminent danger of losing employment, and to the risk of irregular work.

II. How Production is Regulated

Classical political economy teaches us that production is regulated, surely, rapidly, and automatically, by the law of supply and demand. If it should happen that any branch of industry is not sufficiently provided with labour and capital, the goods which it produces acquire a higher value. Attracted by the prospect of higher gains, other producers engage in this favoured industry. Thus the production of the goods is increased, until the quantity reaches the amount desired by the public. On the other hand, capital and labour are withdrawn from unprofitable concerns, till the production of the particular commodity is slackened to meet the level of the amount consumed. In these oscillations the value of goods tends constantly toward a fixed point. This fixed point is determined by the *cost of production*. When the value of an object is equal to its cost of production, we may say that its value is normal. The above conception of the mechanism of production is one of

the celebrated "economic harmonies" of Bastiat and the liberal school. But for the economic mechanism to operate thus admirably in actual practice, many conditions are necessary that are but rarely fulfilled. The supply must respond immediately to the demand, and the demand must immediately take advantage of the supply; the factors of production must be absolutely mobile. Again, this theory presupposes markets that are closely united, like communicating jars of water. Such a state of affairs is as yet far from realization.

All production presupposes an amount of fixed capital which is not transferable at will. Again, it must be borne in mind that the law of supply and demand applies without regard for social usefulness. The most useful vocations tend to become abandoned, while others that are least productive, like saloon-keeping, are sought with great persistency.

Under the old systems no one could enter any trade or profession without the authorization of the Government or of the Guild. The French Revolution proclaimed the principle of the liberty of labour, and this reform was welcomed throughout Europe.

The principle of free labour must be maintained, because it is an essential part of human liberty. But it is perfectly natural that unregulated production should overthrow the perfect adjustment of production to consumption and bring about those disturbances known as *crises*.

III. Crises

Crises have been called "the diseases of the economic organism"; their nature is varied. Some are periodic, others are wholly irregular. Some are

short and violent, others are slow. Some are confined to a particular country, others travel round the world.

Some economists have attempted to construct a general theory of crises. Such attempts must be regarded as premature, though we may discern common characteristics in crises, and find them related to a single fundamental cause. The disturbance of equilibrium is due to a glut or dearth of goods.

(1) *A general glut or scarcity of products.* A general glut is one of the most frequent forms of economic crises, and may be regarded as a kind of chronic ailment of modern industry. The development of large-scale production and means of transportation has enabled industry to throw enormous masses of products on the market. The sale of an article depends on the number of those who have the means of buying it, and, unfortunately, the increase in the income of the bulk of the population has not been so great as the growth of manufactures. Producers, in order to find an opening for their goods, are obliged to lower the prices. This general fall of prices means lower profits or failures for the employers, while for the labourers it means lower wages or loss of work.

Crises caused by scarcity of goods may in certain cases be as formidable. The so-called "cotton famine" which resulted from the American Civil War led to the ruin of many manufacturers of cotton goods. A bad harvest of cereals may cause terrible famines in poor countries such as India.

It may happen that the crisis due to a dearth of one commodity will produce the same results as a crisis due to an excess in production. A shortage in the wheat crop, for instance, causes a rise in the price of wheat; hence consumers of wheat with

limited means are compelled to lower their expenditure for other articles. In this way there is a mass of goods which no longer finds purchasers. This curious state of affairs is illustrated by famines in India, which generally cause a crisis for English manufacturers.

(2) *A glut or a dearth in some factors of production.* In no productive enterprise can the factors of production be brought together in a haphazard fashion. Successful production requires a certain amount of land, labour, and capital, both fixed and circulating. The amount of land in a country is limited. The number of labourers may also be said to have a certain limit, but the quantity of capital does not seem to have any limit at all—at least, in advanced countries. Naturally this abundance causes a fall in the rate of interest, and men try to devise more profitable investments. New enterprises are begun, and finally there comes a “crash.”

The opposite state of affairs is also possible—namely, insufficiency of capital which may follow such crashes, or which may be due to the use of vast amounts of capital in a costly war. Insufficiency of capital may result in a crisis due to a rise in the rate of interest and discount, and difficulty in obtaining money.

Finally, there may be a disturbance of the normal proportion between fixed and circulating capital, the amount of circulating capital being relatively smaller.

(3) *Excess or scarcity of money.* There is a certain proportion between the amount of money that ought to be in circulation in a country and the needs of that country; if the amount is suddenly increased a crisis results. When we have to do with metallic money, it is easy for a country to dispose

of its excess. But this cannot be done when the money is paper money or even bank notes.

A diminution in the quantity of money is regarded by every one as a danger. When the balance of trade has long been unfavourable to a country, a time comes when it has no longer enough money. Exchange becomes unfavourable, the rate of discount is raised, and many merchants become bankrupt. Such conditions are called monetary crises. They are the most dangerous of all, but they have been most carefully studied, and their arrival can be readily foreseen and successfully forestalled.

IV. Over-production and the Law of Markets

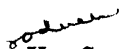
The fear of a general glut is a nightmare that haunts the minds of all business men. Every producer, seeing that his goods sell the better the scarcer they are in the market, naturally concludes that scarcity is a good and abundance an evil.

The economists of the classical school do not like to admit the possibility of any discord in the economic harmony. They maintain that when there is a glut in any branch of production, the best remedy consists in a proportionate increase in the production of other goods. The crisis resulting from abundance can only be cured by abundance. Hence all producers are interested in making production as abundant and as varied as possible. This theory, known as the Law of Markets, was first promulgated by J. B. Say. The greater the resources of all other persons, the better is the opportunity that each of us has of disposing of his goods or services, and the quantity of my resources depends on the amount I have produced.

Even supposing that all products without excep-

tion increase in quantity, there may still be a fall in prices, if there is not a corresponding increase in the amount of money. To sum up, then, the law of markets simply shows that there is no danger in an excess of production whenever the increase takes place simultaneously and proportionately in all branches of production.

Unfortunately, the increase of production never takes place under the conditions required by the theory of markets. There is not one chance in a million that an equal increase will ever occur simultaneously in all branches of production. This is why these crises remain an inherent evil of our economic organization. This is why producers nowadays seek to regulate production by means of commercial agreements known as *trusts* and *pools*.



V. Competition

Competition appears to be the great regulator of the whole economic mechanism of modern society. The following good results are generally attributed to it :—

- (1) It adapts production to consumption.
- (2) It gives a great impetus to production, stimulating progress and effecting a kind of natural selection.
- (3) It tends to cheapen goods.
- (4) It brings profits and wages to nearly the same level in all industries.

Economists of the optimistic school delight in singing the praises of the “harmonies” evolved by free competition. They regard the economic order based on free competition as natural and conclude that it is both perfect and permanent. A more attentive observation of the actual effects of free

competition does not justify a blind faith in it. The present organization is no more or no less natural than any preceding economic system—the family economy, the caste system, or the guild system, which were the natural result of historic evolution. As for the beneficent effects of competition, the following are its main drawbacks :-

(1) Free competition instead of assuring equilibrium between production and consumption at times threatens to disturb this equilibrium.

(2) Although free competition stimulates production, it is also harmful to it, particularly in regard to quality. Each competitor, in order to triumph over his rivals, endeavours to substitute cheap materials for better and more costly ones. Adulteration has now become a veritable art.

(3) Free competition may even cause high prices. The case of bakeries offers a striking example of this paradoxical result. The number of baker's shops is ridiculously excessive. As each of them sells less and less owing to competition, each is obliged to charge more in order to cover expenses. On the other hand, the system of monopoly does not mean the arbitrary rule of the monopolist. Every monopolist finds it to his interest to keep prices reasonably low, on the principle of small profits and large sales.

(4) Free competition does not necessarily cause an equalization of profits and of wealth. Those countries in which competition is most vigorous, *e.g.*, the United States, are those in which the most colossal fortunes are found.

(5) Lastly, free competition is not a permanent state. It tends to destroy itself by giving rise to monopolies ; smaller enterprises are eliminated, and competition tends to cause the formation of giant

enterprises that seek to suppress all competition. Such combinations are generally known as *trusts*.

The economic evolution which is taking place involves three stages : (*a*) competition among small producers ; (*b*) the monopoly control of large producers ; (*c*) regulation by Law. This development which would lead to collectivism or state socialism, is fortunately not inevitable. A system of mutual agreement between workmen and employers through the medium of organizations of both, and also between producers and consumers by means of Co-operative Associations will do away with most of the evils of competition.

CHAPTER II—ASSOCIATION

I. The Successive Forms of Association

THE word *association* to-day almost inevitably suggests the idea of voluntary grouping. But this is a mistake. Association was first the result of instinct, then of coercion, and only recently has it become the result of contract.

The very first form of association was probably the union of sexes. It would be an error to suppose that this association had no economic character. On the contrary, at the outset it had a distinctly economic character.

Association next became coercive in the form of slavery. It was by means of this enforced co-operation that the ancients were enabled to erect the Cyclopean walls and the Egyptian pyramids.

Association gradually became semi-coercive. During the Middle Ages it adopted innumerable and complex forms. Finally it was transformed into association under the leadership of employers.

The classical school holds that the contractual association is the terminating point of social evolution. But we must deny that the present form of association is founded on free contract. The union of employers and employees is an association in fact but not in law ; it is an association in production, but not in distribution. The workers have no feeling whatever of being associated with the employer in a common undertaking.

But legislation now tends to give the wage-system

the character of a real contract. Employers and workers also tend toward this conception by founding organizations and institutions. We may hope that association under the leadership of employers will in turn give way to more thorough and complete association.

II. The Association of Capital

We have seen that the truly free association of labourers has scarcely been tried. The same statement cannot be made with regard to the association of capital. Several capitalists must unite in order to furnish the necessary capital when businesses are conducted on a large scale. Enterprises are generally launched in the form of so-called "stock-companies."

Of the three agents of production—land, labour and capital—the last most readily admits of association, owing to its divisibility and facility of transportation. When each share costs a comparatively small sum, the purchaser may buy exactly according to his wealth or the degree of his confidence in the enterprise. Moreover, labour is not easily moved; land cannot be moved at all, but capital has wings, so to speak. On the other hand, we can hardly agree with those economists who regard this form of association as the coming form of business enterprise. The very fact that it associates only capital and not persons is a sign of inferiority. The stock-holders do not know each other. A stock-company consists of two groups of persons: on the one hand those who share the profits of an enterprise in which they do not work, and on the other hand those who work in an enterprise the profits of which they do not share. This situation involves a singularly unstable state of affairs.

III. Large-scale Production

The most characteristic change of modern times is the passage from production on a small scale to production on a large scale. This kind of organization has assumed such enormous dimensions as to attract public attention and arouse public anxiety. Manufacturing syndicates tend to obtain control of an entire branch of industry in a country and even in the whole world. They are generally called *trusts*, and have developed most remarkably in the United States. Even Governments have been alarmed at their power and increase, and have adopted legislative measures to curb them—measures which generally have proved ineffective.

Yet many persons regard trusts as the preliminary steps toward a new industrial régime, which will establish a proper equilibrium between production and consumption. At all events trusts seem to be successful in preventing the crisis of over-production. Now the evolution which is taking place is due to the fact that it offers certain incontestable advantages. Large-scale production permits of certain undertakings which, because of their size or of the time they require, far exceed the power and the lifetime of an individual. Even in those enterprises which would not actually overtax the capacity of an individual, collective production possesses a marked superiority. By grouping all the factors of production it economizes them. The various economies of large-scale production are worth considering separately :—

(1) *Economy of labour*. In small-scale production much time is lost and some of the workers are obliged to be frequently unoccupied. A hundred

business houses merged in one do not require a hundred cashiers. Large-scale production admits of a more perfect division of labour and saves time by bringing the labourers together.

(2) *Economy of place.* Every-day experience shows that to obtain a hundred times more room in a store or factory, it is not necessary to have a piece of ground a hundred times as large, nor to purchase a hundred times the amount of building materials.

(3) *Economy in natural agents.* A powerful steam-engine consumes, relatively speaking, far less coal than a weak one.

(4) *Economy of capital.* A large shop transacting a hundred times the business done by a small one need not keep on hand a hundred times the goods kept in stock by a small shop. Probably ten times the amount is sufficient. The consumer, moreover, is better satisfied, for in consequence of the frequent renewal of stock, the goods are newer and more fashionable. Again, those who buy on a large scale can secure better bargains, thereby making a more effective use of their capital.

IV. Is the Tendency toward Large-scale Production Inevitable and Desirable ?

If the evolution just described should continue in the future, it would involve the gradual disappearance of all those persons who work under their own guidance. These persons would become employees—*i.e.*, wage-earners. This prospect is agreeable to many economists and to all collectivist socialists. The latter profess a sovereign contempt for small production and individual enterprise. These, according to Karl Marx, are compatible

only with a rudimentary state of production and society.

We cannot accept this sweeping condemnation. The system of small-scale production would be conducive to social peace, and favour a more equitable distribution of wealth; especially it would prevent the bitter conflict between labour and capital. Even from the productive point of view, small production is not so impotent as it is supposed to be. Independent small producers may associate and adopt some of the processes of large-scale production. In agriculture, for example, small farms are not absolutely incompatible with association. Of course, among those who work in manufactures, association will be easier, aided by mechanical inventions that enable us to transport motive power from the place of its generation to the place of its application. Again, there seems to be a limit to the size of business enterprises. At all events, evolution toward large production does not proceed with equal rapidity in all fields of economic activity. It cannot be said in any part of Europe that small farming is giving way to farming on a very large scale. Extensive culture is made possible in the United States by the cheapness of land and the sparseness of population. But when the population will have become dense, it will be necessary to increase the crops by concentrating labour and capital on smaller areas. Large farming may give a greater net product, *i.e.*, greater profit to the landowner, but it generally yields a smaller gross product, *i.e.*, less food and less wages for the nation. Now in view of the increasing density of population, the future will belong to that system of farming that can give the greatest quantity of food.

CHAPTER III—THE DIVISION OF LABOUR

I. The Successive Forms of the Division of Labour

ASSOCIATION means nothing more than the grouping of individual forces, each person performing the same operation ; this may be called *simple co-operation*. Division of labour implies a distribution of work among the associated members in such a manner that each performs a different operation. This may be called *complex co-operation*.

The earliest form of division of labour was the division according to sex. The rudimentary division of tasks thus evolved coincided with the first phase of economic evolution—the phase known as home or family economy.

The second phase—that of corporations or guilds—coincided with a more detailed division of labour, viz., the rise of separate trades. Each guild performed only one kind of labour. The specialization of trades kept pace with the gradual perfection of the guild system.

In the third phase, that of the workshop and domestic manufacturing, the division of labour attains the highest degree of perfection. It was in the workshop that the wonderful phenomenon of the division of labour first attracted the attention of Adam Smith, and led him to write those classical pages on the subject in his “Wealth of Nations.”

In the next phase—that of factories—the division of labour seems almost to have retrograded.

Finally, there is beyond this another form of the division of labour, which may be called *international* division of labour. Each nation devotes itself more especially to those branches of production which seem best adapted to its soil, its climate, and the abilities of its inhabitants. This tendency is now arrested by the Protectionist movement.

II. The Conditions of the Division of Labour

The extent of the division of labour depends on the amount of goods to be produced. In other words, division of labour is directly proportionate to the size of the market. This is why the division of labour prevails to a great extent only in large centres of population. A country shop usually deals in a pell-mell variety of goods, because a single trade would not be sufficient to enable a village shopkeeper to earn a livelihood.

Most books on political economy mention a second condition necessary for the division of labour, viz., continuous not intermittent production ; hence the conclusion is drawn that division of labour is not applicable to agriculture. Division of labour on a farm cannot be managed in the same manner as in a workshop, but it is possible to introduce it in another form by having each man, or group of men, devoted to the cultivation of a specific plant.

III. The Advantages and Disadvantages of the Division of Labour

The reasons why Division of Labour increases the productive power of labour are as follows :—

(1) The most complicated work can be divided

into a series of very simple and almost mechanical operations. It is the division of labour into simple constituent parts that has made it possible to construct machinery for doing work that at first sight appears to be most complicated.

(2) The division of labour creates a great diversity of tasks, and enables us to fit each of these tasks to the individual capacities of the workmen.

(3) The constant repetition of the same task results in developing remarkable dexterity in manual labour.

(4) Economy of time results from continuous work.

(5) The economy of implements reaches a maximum when each labourer employs but one tool and uses it constantly.

(6) A shorter period of apprenticeship is necessary to learn one particular branch only.

But as opposed to all these advantages some serious drawbacks have been pointed out :—

(1) The degradation of the workman, who performs the same simple operation all the time and is thus reduced to the rôle of a mere machine. Lemontey says : “ It is a sad confession for a man to make that during his whole life he has done nothing more than make the eighteenth part of a pin.”

It may be said that the introduction of machinery constantly tends to remove this evil effect of the division of labour. As soon as any productive operation becomes so simple as to be purely mechanical, it will not be long before the workman will be replaced by a machine. Again legislation tries to reduce the length of the work-day, thus leaving the workman spare time.

(2) The extreme dependence of the workman

who is incapable of doing anything except the particular operation to which he has become accustomed, and who therefore is in constant danger of being helpless when discharged.

What, then, must be our final judgment regarding the division of labour? The advantages of the division of labour far outweigh its disadvantages. To be sure there are many kinds of mechanical work that stunt the intelligence, but this is not due to the division of labour. Would the workman who makes pinheads gain much intellectually and morally by making whole pins? The work of a street-sweeper is not divided. Is it therefore nobler than that of a labourer who makes nothing but nails?

BOOK III. THE CIRCULATION OF WEALTH

THE Circulation of Wealth, more frequently called *exchange*, is really only a part of production. Indeed, exchange is not an end in itself. Exchange and credit are really only methods of organizing labour, having the same purpose as association and division of labour. When wealth is once created, the next step is to transfer it ; it does not again change form, but it changes owners.

CHAPTER I—EXCHANGE

I. The History of Exchange

EXCHANGE occupies an exceedingly important place in modern life. Nearly all wealth that is created is produced for the purpose of being exchanged. Our skill and our talents also are most frequently applied, not to satisfy our own wants but those of others. This is why, when we estimate our wealth, we do not estimate it according to its utility for us, but solely according to its exchange value.

In the first phase of industrial organization—that of the family—there could be little exchange, as each group formed a self-sufficing organism.

In the second phase—that of guild production—exchange necessarily results from the separation of trades. It is, however, limited to one town.

In the third phase—that of manufacturing—the market grows wider and becomes national. Here exchange and commerce really begin. The market becomes still larger by becoming colonial. This extension of the market began in the seventeenth century.

Then, finally, in the fourth stage—that of machinery, railroads, and steamboats—the market becomes truly international and commerce acquires enormous dimensions.

II. Exchange Value

The concept of value can exist apart from that of exchange. Even Robinson Crusoe prized some things more highly than others. However, in social life exchange is the sole determinant of value.

The old economists, beginning with Adam Smith, or rather with Aristotle, distinguished two kinds of value—value in use or individual value, and value in exchange or social value. These two values may be quite different from each other. A shilling certainly has not the same value in use—*i.e.*, utility—for a millionaire as for a poor man. On the other hand, it is evident that it has for both the same value in exchange. Value in use is simply the result of individual subjective judgments, value in exchange takes precedence over individual judgments and obliges sellers and buyers to follow the market. This is an economic Law of the greatest importance, and may be formulated thus: *In the same market there can be only one price for merchandise of the same quality.*

What, then, determines value in exchange? Classical political economists gave a formula that was, in appearance at least, simple and perfectly clear; they said that exchange value varies directly with the demand and inversely with the supply.

There are several objections that may be raised against it:—

(1) Despite its appearance of mathematical exactitude, this rule is contrary to facts. If the supply of wheat were diminished by half in a country having no commerce with other countries, its price would be five times as high. On the contrary, if the supply of wine were diminished by half, we may be sure that the price of wine would not be doubled.

(2) It mistakes the effect for the cause. Instead of saying that demand and supply regulate prices, we may as well say that prices regulate demand and supply.

(3) It attributes no intelligible meaning to the terms *supply* and *demand*. The word *supply* may mean the stock existing on the market, although a purely imaginary reduction of the supply may produce the same result as a real diminution. But what are we to understand by *demand*? The quantity in demand is, in fact, absolutely indeterminate, since it depends entirely on the price.

We must therefore inquire what other theories have been suggested in place of the classical formula.

(a) Let us first examine the Utility theory. Very ingenious as an explanation of subjective value, the theory of final utility finds greater difficulty in explaining exchange value. After showing that bread has a different value for each person, how can this theory account for the fact that the exchange value of wheat is the same in one market for millions of persons? In order to explain the uniform exchange value of a commodity, the utility theory says that we must take into account its final utility, not only for the possessor but for possible purchasers.

The manner in which exchange value is fixed in an open market may best be explained by an example.

Suppose there are ten persons prepared to sell ten coats of the same quality. Suppose, further, that the prices for which they are willing to part with their coats range from one to ten shillings respectively. Assume also that there are ten persons contemplating the purchase of a coat. We shall

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suppose that the need of each purchaser is different, and that the price each is prepared to pay varies from one to ten shillings. Now, in the market all the coats must sell at the same price. This price cannot be ten shillings, for there are sellers ready to sell for a lower price and purchasers ready to purchase with every diminution in the price. It cannot be one shilling, for there is only one coat available at that price for sale, and nine purchasers who are ready to pay more. The price will settle somewhere between five and six shillings. It will be, perhaps, five shillings and sixpence, for at this price five coat-owners find it profitable to sell and five intending purchasers find it to their advantage to buy.

The following table will contribute to a clear understanding of the way in which market value is fixed. We assume that there are seven dealers offering seven coats of the same quality but for a different price, and that there are seven buyers prepared to offer seven different prices :—

Coat-owners	A	B	C	D	E	F	G
Price for which each is willing to sell	1	2	3	4	5	6	7
Purchasers	H	I	J	K	L	M	N
Price each purchaser is pre- pared to give	9	8	7	6	5	4	3

A glance at the table will show that the price cannot be one shilling, for at that price only one coat will be offered. It cannot be nine shillings, for only one will be purchased. The price must

be five shillings. It secures the greatest amount of sale, and is beneficial to the sellers and to the buyers.

(b) Let us now examine the Labour or Cost theory. This theory, which founds value on the quantity of labour, at first seems to give a better explanation of exchange value. We must inquire, however, what is meant by *quantity of labour*.

If quantity of labour means the amount of effort expended, then this theory is disproved by facts. Exchange value bears no necessary relation whatever to the time or trouble of production.

If quantity of labour means the sum of values expended in raw materials, manual labour, &c., then this theory no longer explains anything. It simply amounts to the discovery that the value of the whole product is equal to the sum of the values of its parts.

At all events, it must not be said that value is determined by the cost of production. We might as well say that the value of things determines their production and regulates the expenses that are necessary for the purpose. The art of the industrial manager consists in foreseeing what the wants of men will be and what value men will attribute to certain things.

Neither the cost of production nor value is the cause or effect of the other. We may simply say that under the pressure of competition the cost of production and the value of the product always tend to coincide. In a word, we must conclude with regard to exchange value, as well as with regard to value in general, that it is fruitless to seek a single cause.

The following two points must be noted in connection with exchange value :—

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(1) The current price must be such that demand and supply coincide exactly.

(2) The current price must be such that all parties, even the least favoured, secure a gain in utility.

These two conditions of exchange relation are together necessary and sufficient. The old formula of supply and demand possessed the merit of indicating very well the various elements of value.

III. How Value is Measured by Exchange

To measure the value of a thing is to measure the intensity of the desire which that thing calls forth within us. We have an accurate measure of desires, viz., Exchange. In order to obtain what we want we must relinquish a certain quantity of the wealth we possess. It is perfectly correct, therefore, to declare that the value of a thing is measured by the quantity of other things for which it can be exchanged ; or, more briefly, the value of a thing is expressed by its purchasing power.

If I can exchange an ox for ten sheep, I may say that the value of an ox is ten times that of a sheep. This may be expressed in the formula : *The values of any two commodities are inversely proportionate to the quantities exchanged.* The greater the quantity of a commodity that I must relinquish in exchanging it for another, the less is its value as compared with the other commodity, and vice versa.

IV. The Advantages of Exchange

The physiocrats regarded exchange as unproductive. They argued, sophistically, that exchange, if

equitable, presupposes the equivalence of the two values exchanged, and, consequently, that there can be neither gain nor loss on either side unless one party is cheated.

If exchange never led to profit, or if every exchange necessarily implied that some one had been cheated, it is difficult to understand why men have persisted for so many centuries in carrying on exchange. In reality, each party to an exchange thinks that by it he receives more than he gives. However strange this may appear, it is right, for utility is purely subjective, and varies according to the wants and desires of each person. Now we shall state the advantages of exchange.

(1) Exchange enables us to utilize, in the best way possible, a large quantity of wealth which, without exchange, would remain unused. Without exchange, what would England do with her coal? We must regard exchange as the last of the series of productive acts.

(2) Exchange enables us to utilize in the best way a host of productive capacities which, without exchange, would remain inactive. If there were no such thing as exchange, each man would be compelled to produce all that is necessary to supply his wants. He would be obliged to regulate his production, not according to his aptitude but according to his wants.

It may be said that these advantages of exchange resemble those afforded by the division of labour.

V. The Means of Facilitating Exchange

Exchange would be almost impossible had not ingenious means been contrived for facilitating it. The means may be classified as follows :—

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(1) The formation of a class of middlemen called *merchants*.

(2) The invention of a commodity called *money*, enabling us to divide barter into sale and purchase.

VI. History of the Part played by Merchants

Contrary to what we might be disposed to believe, commerce or exchange did not first take place among neighbours. Exchange was first practised among peoples and regions far distant and different from each other. Commerce was international before it became local ; it was maritime before it became overland. At the beginning, moreover, merchants were persons of great note—men who were envied and feared. Trade or commerce on a small scale, and particularly retail trade, is of comparatively recent origin.

In the evolution of trade two stages may be noted :—

(1) The first stage is that of travelling traders. This condition survives in small towns where pedlars carry their goods about in quest of customers. But the system of itinerant traders is impossible, except for goods that can be easily transported. Moreover, it is a costly method.

(2) Therefore, whenever commerce attains any development the travelling trader soon gives way to the sedentary trader or shopkeeper. Formerly the trader sought his customer ; now the customer must find the trader ; but attempts are made to attract the attention of the purchasers by advertisements, travelling agents, &c. These commercial travellers, however, differ from the travelling traders : they carry samples with them instead of the goods.

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The advantages to society from the existence of traders are these :—

(1) They serve as intermediaries between the producer and the consumer and save the time of both.

(2) They buy goods wholesale and sell them retail, and thus avoid the difficulty which would result from a difference between the quantity offered by the producer and that desired by the consumer.

(3) They keep merchandise in stock. The producer rarely wants to sell goods at exactly the time that the consumer wishes to buy.

These are, no doubt, important services rendered by merchants, but we must inquire how much they cost to society. Owing to an increase in their number, middlemen tend to become social parasites. When, in addition to this, we consider the frequent adulteration of goods and the untruthful advertisements, we must ask whether the services rendered by these intermediaries are not too dearly paid.

Attempts are made to devise effective remedies for this evil. Two kinds of associations are coming into prominence—the association of producers who agree to sell to the public—directly (*e.g.*, agricultural syndicates), and the association of consumers who agree to buy directly of the producers (*e.g.*, co-operative societies for consumption).

It is not impossible that the day will come when there will be no more traders.

VII. The Means of Transportation.

The following difficulties of Transportation may be noted :—

(1) *Distance*. Man's genius cannot do away with distance, but practically the obstacle of distance is

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converted into one of time, and human ingenuity has been singularly successful in reducing the time necessary for traversing a given distance.

(2) *The nature of commodities.* Weight, danger of injury, perishability, &c., are hindrances to transportation, but they may be partly overcome by rapidity of conveyance.

(3) *The nature and condition of roads.* This is the most serious obstacle of all, but it is also the one that human industry has coped with most successfully. By sea there is no need to build a road. On land the difficulties are greater. Road-building is a costly matter ; the better the road the more it costs.

VIII. The Division of Barter into Sale and Purchase

When exchange is carried on directly, commodity for commodity, it is called *barter*. It is an inconvenient and almost impracticable operation. It requires a double coincidence. We have to find a man who can give just what we want and who wants just what we can spare. The difficulty increases when perishable articles like eggs are to be exchanged for indivisible ones, like horses, oxen, carts, &c. The invention of a third commodity to serve as a go-between removes the difficulties and divides barter into two distinct operations—sale and purchase. The two processes, although separated, nevertheless continue to form a whole. Every purchase means a prior sale, and every sale points to a future purchase. In thought, these two operations must be connected.

CHAPTER II—METALLIC MONEY

I. The History of Money

ACCORDING to circumstances, many commodities have served as the medium of exchange ; for example, cattle, rice, packages of tea, salt, and coloured calico. But the metals gold, silver, and copper attracted man's attention in all civilized societies from the earliest times. By virtue of chemical properties which make those metals comparatively unchangeable, they are furnished by Nature in a relatively pure state. They soon took the place of every other commodity as a suitable intermediary in exchange.

The natural properties which give the precious metals a marked superiority over all other commodities are :—

(1) *Facility of transportation.* No other objects have so great a value in so small a bulk.

The importance of this quality of precious metals is much greater than at first appears. The precious metals are, of all commodities except precious stones, the most easily transportable. For 1 per cent. of its value gold or silver can be conveyed from England to a Chinese port. Hence the value of the precious metals is almost the same the world over. Of course, in mining districts, where these metals are produced, their value is somewhat lower than elsewhere. Nevertheless, we may say that the value of these metals is invariable from place to place.

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(2) *Unlimited durability.* By virtue of chemical properties, gold and silver may be kept unchanged for an indefinite period. No other wealth is so durable. This characteristic has the same effect with regard to time as the preceding has with regard to place. It insures a relative invariability of value from one period to another. The annual production of these metals, compared with the immense permanent accumulation of gold and silver, is as unimportant as a river compared with the ocean. Yet variations in the output of precious metals may, in the long run, become perceptible. If the rate of annual increase were 5 per cent. of the supply, the stock would be doubled in about fifteen years. When long periods are considered, the value of these metals offers a far less satisfactory guarantee.

(3) *Identity of quality.* The precious metals are always identical—that is to say, one piece of pure gold is like every other piece of pure gold.

(4) *Difficulty of counterfeiting.* The precious metals, because of their colour, weight, and metallic ring, may be recognised at once. No other substances are likely to be mistaken for them.

(5) *Perfect divisibility.* By divisibility, we mean economic divisibility. The value of each fragment of an ingot is exactly proportionate to its weight.

Jevons enumerates seven qualities which the material of money should possess : (1) Utility and value ; (2) Portability ; (3) Indestructibility ; (4) Homogeneity ; (5) Divisibility ; (6) Stability of value ; (7) Cognizability.

The use of the precious metals as money has an interesting history, extending through several distinct stages :—

(a) First, the precious metals were used in the

shape of crude ingots. In every exchange transaction these ingots had to be weighed and assayed.

(b) The inconvenience of being required to weigh and assay metals led men to conceive the idea of using cut ingots, the weight and standard of which were fixed beforehand and guaranteed by some official stamp.

(c) Still another step had to be taken. The irregularly shaped piece of metal was inconvenient, and in spite of the stamp impressed on it, nothing was easier than to clip it without leaving any traces of the debasement of its value. To remove this difficulty, men have adopted the form of coined money that is now thoroughly familiar to all civilized nations.

II. Is Money a Superior Kind of Wealth ?

The popular answer to this question admits of no doubt. At all epochs and in all places, except among savages, money has occupied an exceptional place in the thoughts and desires of men.

It would be interesting to trace through history the various manifestations of the idea that confounds gold with wealth. The mediæval alchemists attempted to transmute the baser metals into gold.

In later times, we mark the enthusiasm kindled in the Old World by the arrival of the first gold-laden galleons from America, and the subsequent belief that in the new Eldorado an end would be found for all human misery. A similar idea underlay the complicated systems introduced by most European Governments in the sixteenth and seventeenth centuries to cause the influx of gold into countries that had none, and prevent its exportation from those that were well provided with it. Even

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to-day the anxiety with which statesmen and financiers watch the exportation and importation of coin is fundamentally due to the same conception of the importance of money.

But if we ask the economists whether or not money is a superior kind of wealth, the answer will be entirely different from the popular opinion. Economists have maintained that money is a commodity like all other commodities, and even inferior to others, because it is in itself incapable of satisfying any want directly. It is, consequently, the only commodity of which we may say that its abundance or scarcity is a matter of perfect indifference.

These two contradictory opinions may easily be reconciled. The public is right, from the individual point of view ; the economists are right, from the general or social point of view.

Every piece of money may be regarded as a ticket or order, giving the bearer the right to claim a part of the wealth not exceeding the value indicated on the coin. It is clearly our individual interest to possess as many of these orders as possible. These orders are far more convenient than any other kind of wealth. A particular commodity corresponds only to a special and determinate want, while money corresponds to an indeterminate and universal want. The owner of a very useful commodity may not know what to do with it. The possessor of money is never thus embarrassed ; he can even keep it for a more favourable opportunity.

But if we regard the whole mass of individuals constituting society, the point of view changes and the economist's thesis is more correct. If the amount of money in the possession of all the members of a community increases tenfold, no one is richer

than before. In other words the purchasing power of each coin would be one-tenth as great.

Yet in their relations with each other particular countries, as well as particular individuals, gain by being well provided with money. It is, of course, true that an abundance of money in one country would cause its value to fall there, but it would still retain, at least for a while, its former purchasing power in foreign markets. The economist's thesis, that the quantity of money is a matter of indifference, is not perfectly true until we extend our purview so as to embrace all mankind.

III. Disturbances caused by Fluctuations in the Value of Money

If gold and silver lose one-tenth of their value, it is evident that the price of all objects, *i.e.*, their value expressed in money, must have increased. We may therefore formulate the following law :—

Every fluctuation in the value of money causes a proportionate inverse fluctuation in prices.

As the quantity of gold and silver is the principal factor affecting the value of money, we may add this second formula : *Every fluctuation in the quantity of money causes a proportionate change in prices.*

It is, therefore, very difficult to tell whether or not the value of commodities has really changed, for the only measure we have is itself subject to variations. Several devices have been suggested for detecting and correcting apparent variations in value which are due to variations in the standard. The system of "index members" is, however, most current.

Suppose that a list of all commodities with their prices were prepared at a given time. Now suppose

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after some years we prepare a new list of these commodities, and, on comparison, we find that all prices had increased 50 per cent. We should then declare that the value of money had really fallen 33 per cent. If we have to pay three shillings where formerly we paid only two, it is clear that money has lost one-third of its purchasing power or value.

This conclusion can have but one of two explanations. Either all commodities have undergone a general and parallel rise in prices, or the value of money has fallen. The second explanation alone appeals to common sense.

A general and uniform rise in prices never takes place; some prices rise, others remain stationary, and still others fall. Yet if, during any period, skilful calculations show that an average rise of 10 per cent. has taken place, for the reasons given above, this could be accounted for only by an equal and inverse change (*i.e.*, fall) in the value of money. Economists have recently attempted a calculation by lists of "index numbers." These lists include the principal commodities with their prices at a given epoch. To simplify the use of these calculations, it is customary to express the total for the year which serves as the basis of comparison as 100. A list is prepared for each year under study, and the totals for other years expressed upon this basis. A comparison of totals indicates whether the prices increased, diminished, or remained stationary.

IV. Whether Metallic Money will Continue to Decline in Value

The depreciation of metallic money during the past thousand years is a historic fact. Neither gold

nor silver is as rare as it is supposed to be. The rapid progress of metallurgy is continually lowering the point below which it does not pay to extract the metal from the ore. It is therefore probable that the precious metals will continue to fall in value.

It may be maintained that the demand for these metals will be increased by the growth of population and the development of exchange, and that this increased demand will counterbalance the effects of an increased supply. But we must remember that this factor is in turn more than counterbalanced by the improvement and extension of the credit system. In the great modern financial centres a vast amount of business is carried on by means of credit devices and clearing-houses, practically without the intervention of money.

This depreciation is not a matter of indifference. In reality it is a phenomenon of great social importance, the effects of which must be regarded as beneficent. First of all the depreciation of money results ordinarily in a rise of prices. This is favourable to production ; it sustains the spirit of enterprise and tends to increase wages.

Moreover, depreciation is favourable to the debtor classes, inasmuch as they have to pay less than that which they received. It is true that to the very degree that the depreciation of money is favourable to the producer and to the debtor, it is prejudicial to the consumer and to the creditor. Yet even this effect is desirable, for if the consumer is also a producer, his increased expenditure is easily counterbalanced by the increased value of his products or by higher wages. If he is only a consumer, so much the worse for him ; the higher prices only put a perfectly legitimate burden on

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him. As for the creditor, if his credit constitute the basis of a permanent income, it is no more than right that the gradual reduction of his income should warn him that he is playing the part of a parasite.

V. The Conditions which should be Fulfilled by all Good Money

All legal money should have a metallic value strictly equal to its nominal value.

Money has a twofold function: it is the sole instrument of purchase, and the only instrument for the payment of debts. Both these functions are the results of custom, but both require the sanction of law. This legally privileged position of money makes it what is called legal tender. But the legal tender quality is based on the condition above indicated.

Every piece of money must therefore be regarded from two points of view. As a coin, it possesses a fixed value, marked upon its surface. As an ingot, it has a value equivalent to the market value of the metal it contains. Whenever these two values coincide we say that this money is good or sound money.

If the value of the ingot be higher than that of the coin, the money is said to be heavy. But as soon as the public discovers this, it will regard coins as bullion, and will sell them by weight. This process will continue until the coins have completely disappeared.

If the value of the ingot be less than that of the coin, money is said to be light. This is seriously to be dreaded, because, once such light money has entered into circulation, it remains most persistently.

To maintain the identity of metallic value and legal value, it is customary under every good monetary system to give anybody the right to have metal coined into money by the Mint. This is called *free coinage*. As long as it exists, the identity of values is guaranteed.

There are, however, in all countries certain kinds of coins which do not fulfil the preceding requirements: their intrinsic value is inferior to their legal value. These coins are called *subsidiary* or *token money*. They are usually coins of small value. They are not legal tender for large payments. There is no free coinage for token money.

A few terms should be noted in connection with coinage.

Brassage. The actual cost of coinage is sometimes called *brassage*. Some Governments transform metals gratuitously into money. England is an example of this.

Seigniorage. The term *seigniorage* is used to designate the charge required by the Government in addition to the actual cost of coinage.

Gratuitous coinage and free coinage. Where the Government pays the *brassage* we call it *gratuitous coinage*. Free coinage does not mean that coinage is done for nothing. It means only that any private person has a right to bring bullion to the mint and get it coined. It should be noted that sometimes the term *seigniorage* is used to include *brassage*.

VI. Gresham's Law

In every country where two kinds of legal money are in circulation, the bad money always drives out the good. •

This is one of the most curious laws of political

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economy, named after the commercial adviser of Queen Elizabeth. Men always prefer good merchandise to bad. Why, then, should men act differently when money is the article in question?

Our astonishment ceases when we reflect that money is not destined, like other wealth, either for consumption or for production, but solely for exchange. This explains why bad money continues in circulation, but not why good money disappears. It disappears in three ways : by hoarding, payments abroad, and sale by weight.

(1) *Hoarding*. When people want to hoard money for possible urgencies, they choose the best pieces, because these offer the greatest security. This cause of the disappearance of good money, however, is temporary.

(2) *Payments abroad*. It is always necessary for a country to send a certain amount of specie abroad to pay for its imports. Now a foreign creditor takes the money for the weight of fine metal it contains. Therefore the light money is kept for use at home, and the good money reserved for foreign commerce.

(3) But good money disappears most rapidly from circulation because of its *sale by weight*. As soon as gold money is worth more as metal than as coin, it is clearly profitable to stop using it as money and to regard it as bullion. Good coins are withdrawn from circulation and find their way to the market for precious metals.

Gresham's Law is applicable in the following cases :—

(a) Whenever worn money is in circulation together with newly coined money.

(b) Whenever depreciated paper money is in circulation together with metallic money.

(c) Whenever light money is in circulation together with good money, or even when good money is in circulation together with heavy money. In this case the lighter money drives out the other.

VII. The Necessity of employing Several Metals and the Difficulties which result therefrom

Every civilized country is obliged to employ simultaneously coins of gold, silver, and copper, or some similar metals. But there is no need to use all three as legal tender; in fact, copper is always token money. Only the other two are of interest in this connection. Should both precious metals receive the character and attributes of legal tender, or should only one be thus employed? This question, formerly called "the problem of single or double standard," is now termed "the problem of mono-metallism or bimetallism."

If only one metal, say gold, be legal tender, there is no difficulty. Silver coinage is relegated to the rank of subsidiary money.

If we allow both silver and gold coins to assume the character of legal tender, the matter becomes complicated. A brief review of the monetary history of the United States will illustrate this difficulty.

In 1792 the double standard of gold and silver was adopted. Soon afterward silver cheapened. As a result gold went out of circulation and entirely disappeared in 1817. In 1834 the ratio of 15'60 to 1 was proposed, but finally the ratio 16 to 1 was adopted. As gold was over-valued, silver coins began to disappear. In 1873 the silver dollar was dropped from the list of authorized coins. At about the same time another great change took place. The discovery of the silver mines in the West and

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the demonetization of silver money from Germany changed the relative value of the metals. In 1876, one pound of gold could purchase 21 pounds of silver. There were a few attempts to make silver dollars full legal tender, with the result that gold was going out of circulation.

The most striking lesson to be drawn from this monetary history is that the concurrent circulation of the two metals can continue only so long as the market ratio coincides with the legal ratio.

VIII. Why Bimetallist Countries really have but One Money

“What does it matter,” it may be asked, “if our gold or our silver coins have a legal value a little above or a little below their real value? No one notices it, and in any case no one suffers from it.”

This is a mistake. A regular movement of flux and reflux carries away the metal that is high in value and brings into the country that which is low. Every country which is nominally under the double standard system falls into the singular position of never being able to keep in circulation more than one kind of money, and this one the worse. This is only the application of Gresham's Law.

In France under the second empire there was practically only gold currency because silver coins were under value. A London banker took gold to Paris, got it coined, converted it into silver francs and exported whole shiploads of silver coins to India, where they were turned into rupees. It was not long before there was a veritable dearth of silver money in France. It was therefore necessary

to diminish the weight or reduce the fineness of silver coin. By common agreement on the part of France, Italy, Belgium, and Switzerland, the standard of fineness for all silver coins except five-franc pieces was lowered in 1865. All these coins then became, and have since remained, token money. The exception in favour of five-franc pieces was insisted on by France. Naturally the five-franc piece continued to leave the country; but it could be dispensed with more easily than the small change.

From 1871 on a reversal was effected in the respective value of the two metals. Silver began to increase in circulation. The nations belonging to the Latin Union sought to avert this new danger in 1878. The coinage of five-franc silver pieces was completely suspended. This measure fully succeeded. There was no longer any profit in buying silver abroad, for it could no longer be coined into money in France.

We may, therefore, say that although the nations of the Latin Union are still legally under a system of bimetallism, they have in reality adopted gold monometallism. Of all their silver coins, only one is legal tender, and this one is no longer coined!

IX. Whether it is Advisable to adopt the Monometallic System

There seems to be no room for hesitation. The monometallic system is infinitely more simple than bimetallism. It avoids all the difficulties that have just been enumerated. The gold standard prevails in the greater number of nations. The only important countries having bimetallism are the United States, the Latin Union, Holland, and Spain. The

only countries of importance which have the silver standard are China and Mexico.

Of the bimetallist countries mentioned, the principal ones are in reality gold monometallist in the sense that they employ only gold for international exchange.

Why do these nations not cut the tie that binds them so slightly to bimetallism, and adopt monometallism as other nations have done? There are two difficulties in the way of this step, one practical and one of principle.

(1) The practical difficulty is that the adoption of the gold standard means the demonetization of silver. The withdrawal of silver dollars in countries like the United States, even in part, involves a serious cost.

(2) The objection on principle is that fluctuations in prices are much more to be feared with a single standard than with a double standard. The fluctuations in prices will be frequent and abrupt when one metal is used as a standard. When two moneys are used there arises a sort of compensatory influence. Indeed, a new discovery of gold-mines may justify these fears. The exhaustion of gold-mines would cause an even more formidable perturbation.

Bimetallists endeavour to convert the gold-standard nations, and maintain that none of the difficulties that are feared would arise if bimetallism were adopted by international agreement on the basis of 16 to 1, or on the basis of any other fixed ratio. This assertion seems preposterous to the economists of the classical school. They declare that the value of things is regulated solely by the law of supply and demand, and is wholly beyond the scope of legislative control.

In our opinion, this line of argument adopted by the classical school requires some qualification. When we speak of the demand for precious metals, we mean almost exclusively the demand by a dozen or more government mints. Hence there is nothing absurd in the supposition that if these dozen buyers should agree among themselves to fix the price of gold and of silver they could succeed in doing so. The classical school says that it would be absurd to declare that an ox shall always be worth ten sheep ! Certainly it would ; the market for these commodities is immense. But if in the whole world there were only a dozen buyers it is highly probable that by concerted action they could fix prices at the ratio of 1 to 10 or at any other ratio that pleased them. No doubt this line of argument must not be carried to absurd extremes, but within reasonable limits we do believe that an international agreement would be efficacious in determining the relative values of the two metals, and in eliminating the principal disadvantage of bimetallism, namely, the disappearance of one of the metals. For whither could it disappear when in all countries it is subject to the same law ? It would appear, however, that such an international agreement is not practically possible as so many gold-using nations are against the arrangement.

CHAPTER III—PAPER MONEY

I. Whether Metallic Money can be replaced by Paper Money

IT is manifestly absurd to substitute for wheat or coal mere pieces of paper on which are inscribed such words as "One Hundred Bushels of Wheat" or "One Hundred Tons of Coal." Such pieces of paper could not provide either food or warmth. But we know that money is unlike any other wealth. A piece of money is nothing but an order giving its possessor the right to claim a certain share of existing wealth. The part played by an order can be taken by a piece of paper quite as well as by a piece of money. To Law the financier is due the credit of having perfectly understood and demonstrated this possibility.

Paper money may be divided into three classes :—

(1) Representative Paper Money merely represents an amount of coin that has been deposited somewhere. This kind of paper money is secured by coins for which paper is simply a substitute. The American gold and silver certificates, guaranteed by gold and silver deposits in the Treasury of the United States, are good examples of this kind of paper money. They are receivable for all public dues, but are not legal tender.

(2) Fiduciary paper money takes the form of credit instruments. It is a promise to pay a certain

sum of money. The value of the paper depends on the solvency of the debtor. The national banks of the United States issue money of this sort, guaranteed by Government bonds deposited with the Treasurer of the United States.

Fiduciary money (or, as it is sometimes called, *redeemable* or *convertible* money), when issued by the Government, is secured only by the general solvency of the Treasury department, and not by specific deposit. This is not quite safe. The assets on which the Government relies for payment may fail in an emergency; and the dangerous power possessed by the Legislature of declaring such notes a legal tender, even if they are not redeemed, is a constant menace to financial stability.

(3) Conventional paper money represents nothing and confers a claim to nothing. The name *paper money*, in its strict sense, is generally confined to this category. It consists of strips of paper issued by a government having insufficient metallic money. These strips of paper have the appearance of promises to pay, but every one knows that this is a pure fiction. Conventional paper money (also called *irredeemable* or *inconvertible* paper money) may be regarded as money on which the Government has charged 100 per cent. seigniorage. This kind of money either is issued as such directly by the State, or is the result of the degeneration of money that was once convertible.

The substitution of paper money in this third form for metallic money seems hard to understand. It has, however, frequently been accomplished in many countries. These strips of paper serve the very same purpose as coins. Yet we must admit that between the value of paper money and that of metallic money there are important differences. The

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value of the former is always more precarious, more restricted, and more changeable.

(a) The value of paper money is precarious because it is dependent on the will of the legislator, and can be annihilated as well as created by law. Should the law demonetize paper money the holder will have in his possession nothing but bits of paper. The same thing is not altogether true of metallic money, for besides its legal value it has also a natural value.

(b) The value of paper money is more restricted, *i.e.*, its circulation is limited to a narrower area than metallic money. It cannot be expected to circulate beyond the boundaries of the nation which issues it. Metallic money, on the other hand, can circulate everywhere—if not as coined money, at least as bullion. Paper money is essentially a national money, while metallic money is universal and international.

(c) Finally, the value of paper money is more changeable than that of metallic money, for the excellent reason that the quantity of paper money depends solely on the will of Government, while the quantity of metallic money depends on natural resources. An imprudent government can depreciate paper money by issuing more than is needed, but no government on earth can depreciate metallic money in this manner. Even a prudent government cannot remove some of the disadvantages of a paper currency. The need for money varies from time to time, according to circumstances. A period of great business activity, requiring an increase in the instruments of exchange, is followed by a period of depression. In the first period there will probably be a dearth, while in the second an excess, of paper money. This is true to some extent of

metallic money. But the precious metals are sought and accepted everywhere, and if they are in excess in one country they naturally flow into others.

The above three disadvantages of paper money would vanish if all civilized countries would bind themselves--

(1) To confer the legal tender quality on only one kind of paper money, which shall be accepted everywhere.

(2) To augment its quantity only in a measure fixed in advance and calculated for each nation.

II. Whether the Creation of Paper Money is equivalent to the Creation of Wealth

The idea that wealth can be created by paper money is evidently absurd, for it assumes that wealth can be created out of nothing. Yet it has been ridiculed too much. Adam Smith first offered an explanation. In a comparison that has since become celebrated, he declared that to do away with metallic money would be like doing away with roads : if we found the means of travelling in the air, we could restore to cultivation all the surface of the earth that is now devoted to transportation by land. This ingenious comparison, however, is not entirely satisfactory.

We can see readily enough that when roads and railways are no longer required, the land they occupy may be cleared and put under cultivation ; but it is not so easy to see what can be done with the metallic money when it is dispensed with for currency purposes. There would be little economic gain by converting it into gold and silver plate. What would really result is this : the money would be invested abroad, and thus bring considerable

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revenue. Paper money may increase the wealth of a nation by the total amount of metallic money in circulation. In practice it would be daring to go quite so far, however.

But it must be observed that the gain could not be made by all countries at the same time. One country could utilize its supply of metal productively by selling it abroad, but if every country wished to do this, it is evident that none would succeed.

Nevertheless, there would still be some advantage to mankind in abandoning the use of precious metals as money. All the labour devoted to the maintenance of the supply of these metals could be utilized for productive purposes.

In short, we must not say that paper money increases the wealth of a nation to the extent that it increases its supply of money, but, on the contrary, to the extent that it permits of reducing its supply of metallic money.

Such is the economic advantage to a nation of the emission of paper money. The fiscal advantage to a government is more clear. When a government falls short of money the creation of paper money is a very convenient way of paying without being obliged to borrow, and hence without being required to pay interest. Of course, excessive issues of paper money, without regard to the amount of coin in circulation, must cause depreciation of the paper and a loss to the Government and the nation.

III. The Dangers resulting from the Use of Paper Money and the Way to Prevent Them

The advantages that paper money can procure for a country or for a government are real enough, but they may be dearly paid for. Some economists

have gone so far as to say that paper money is the greatest plague of nations. It may be noted, however, that the evil effects are due rather to the imprudence of governments than to the nature of paper money itself. Indeed, they are produced only when a government, overstepping the proper limit, issues more than is needed. There are several signs, familiar to the economist and the financier, which should warn us of the danger even when it is far off.

(1) The first of these signs is the premium on gold. The depreciation of paper money does not affect gold and silver; these metals retain their former value. Bankers begin to seek bullion to send abroad, and they will pay a small premium to obtain it.

(2) The second sign is a rise in the rate of exchange. Foreign bills of exchange are sold in all the great commercial centres of the world. Like any other commodity, they have a market price; this is called the *rate of exchange*. The bills or claims on foreign countries are generally payable in gold. When paper begins to be depreciated, these bills will naturally rise in value like gold itself.

(3) The third sign is the flight of metallic money. However slight the depreciation of paper money, all the metallic money will speedily disappear from a country.

(4) The fourth sign is a rise in prices. This appears later on, and shows that the evil has already become a grave one. While the depreciation of paper money is slight, prices except those of the precious metals are not affected, but when the depreciation reaches 10, 15, or 20 per cent. the evil suddenly bursts forth.

(5) Finally we must note that the old prices

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continue the same for those who can pay in metallic money, for metallic money has lost none of its value. Hence we observe the curious phenomenon of two different sets of prices for commodities. Every article now has two prices—one payable in metallic money, the other in paper money. The difference between the two prices exactly measures the depreciation of the paper money.

IV. American Paper Money

The first Government paper money in America took the form of "bills of credit" issued by the colony of Massachusetts in 1690. In 1692 they were made legal tender in all payments, and as these were redeemable in silver after twelve months, they were equivalent to silver. Once introduced, however, the idea of issuing paper money spread to the other colonies, and was greatly abused. During the revolutionary period the Continental Congress, having no other means of raising money, had recourse to this expedient. In 1775 "continental" paper currency was declared legal tender, and fresh issues followed in rapid succession; despite the attempts to prevent depreciation, however, it quickly became valueless.

After the establishment of the Union, various issues of paper money were tried, both by separate States and by the Government, but with the almost invariable result of a steady depreciation in the value of the paper. The most successful "legal tender" paper took the form of "Treasury notes," running for three years and bearing interest not exceeding six per cent. payable in "lawful money."

Of essential significance is the effect of depreciated paper money on wages. The course of events,

at this time, shows that, in times of inflation, wages rise less quickly than prices, and that the period of transition is one of hardship to the wage-receiving classes.

Since 1879 the notes have always been redeemed in coin.

V. How even Paper Money may be Dispensed With

Paper money economizes metallic money, but it has serious disadvantages. There is another method which is more effective and less dangerous than paper money. It consists in doing away with every instrument of exchange.

In the first place: We replace cash sales by sales on credit.

In the second place: We seek to have these promises to pay fulfilled in some other way than by actual payment in metallic money.

It was first of all in international commerce that men learned to employ credit and to dispense with the direct use of money. The foreign bill of exchange is the first form of negotiable paper known to English Law. In the seventeenth century inland bills of exchange came into use between merchants in different parts of England.

A bill of exchange or a draft is a written order by which the person drawing the bill orders some other person, upon whom he has a claim, to pay a specified sum of money to a third person. These bills are payable either at sight or at some specified time. They may by endorsement be transferred from one person to another. In this manner one bill may serve to make many payments before the drawee is called upon to make final payment.

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The use of such bills avoids the manifest absurdity of sending two shipments of coin across the ocean. Without such ingenious devices as this, international trade would be impossible.

In the transaction of business between individuals we are by no means so advanced. Yet exchange between individuals could be effected by the same system as that used between nations, namely, selling on short credits, creating bills of exchange, and passing them from person to person until they are counterbalanced by each other.

But we can conceive another method infinitely more simple in theory and easier to understand. Suppose that all our citizens opened an account at the same bank, and that it were the business of the bank to register everybody's sales and purchases. Accounts then would be balanced by means of book credits and book debits. Such a system as this would dispense entirely with money. At the end of the year the bank would send a statement to each person indicating his account for the year.

VI. How Improvements in Exchange tend to bring us back to Barter

The present tendency is to do away with the instrument of exchange and bring us back to Barter. Is not international trade now really carried on by barter? It is virtually a kind of barter that makes the cheque system and the great institution of the clearing-house possible. There was a time when merchants kept their money in their own strong boxes. But in the course of time goldsmiths obtained the privilege of keeping this in their vaults. Merchants would simply give their creditors an

order on the goldsmiths. The importance of such orders has steadily increased. They now serve very extensively as a substitute for money. A cheque may be defined as an order on a bank to pay some one a specified sum of money. It can be drawn only against a deposit of money in the bank or against a credit previously agreed to by the banker.

If cheques are drawn by different persons on the same bank, the matter is perfectly simple. Now suppose that each of these persons has an account at a different bank. The recipient of the cheque simply deposits it at his own bank and is credited for the amount of the cheque. In the course of a day's business each bank receives a great variety of cheques drawn upon different banks. Then the representatives of the various banks meet at a clearing-house and balance their claims against each other. Banks situated in different places settle their accounts with almost equal ease. They have their agents in the nearest clearing-house city.

Thus the clearing-house really reverts to a sort of barter. It is, in fact, a colossal bazaar like those which existed in the cities of antiquity. The only difference is that here not the goods themselves are exchanged, but the certificates that represent them.

The precious metals, although they are losing their position as instruments of exchange, still retain their function as the measures of value ; for the value of all these papers, cheques, bank notes, &c., is based on metallic money.

We cannot be sure that the precious metals will not some day lose their privileged rank as a measure. We can conceive a social state in which the money of account is purely nominal. The *livre*

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tournois in France and the modern English guinea are not represented by any coin.

Only when money has become a pure abstraction shall we fully attain the social state in which all receipts and payments are effected by a thorough system of book-keeping.

CHAPTER IV—INTERNATIONAL TRADE

I. The Balance of Trade

THE term *balance of trade* designates the relation between imports and exports. Statistics show that the imports and exports of a country are rarely equal. Since 1893 the United States has always imported less than it exported. France shows the opposite state of affairs. Her imports exceed her exports. If we consider the case of England, the statistics are still more surprising. The annual excess of imports over exports averages an immense sum. In other words, one year of foreign commerce at this rate would suffice to drain the country twice of all its metallic money.

It is clear that these figures are deceptive. In order to ascertain whether the foreign trade of a country is in equilibrium, we must consider, not only the balance of its imports and exports but the balance of its credits and debits. The balance of credits and debits, or the balance of accounts, is not the same as the balance of trade. There are numerous other international claims which are termed *invisible exports and imports*. The following three stand out pre-eminently in importance :—

(1) The *cost of transportation* of exported goods, *i.e.*, freight and insurance. If the exporting country has charge of the transportation of its goods, it has a claim on other countries that certainly will

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not be counted among its exports. England has large claims of this kind against other nations.

(2) The *interest on capital invested abroad*. Rich countries invest abroad a large part of their savings, and so receive each year large amounts of money. India and the Australian colonies have negotiated in England the sum total of their loans. Numerous enterprises throughout the world are in the hands of English financiers. In the United States Englishmen own land having a total area equal to that of Ireland. Spain, Turkey, Egypt, India, and the South American republics appear as debtors. As long as the loans issued by these countries are not fully subscribed, they become creditors of the countries which take up the loans.

(3) The *expenses incurred by foreigners living in the country*. All countries which are resorted to by foreigners are constantly receiving large sums of money from abroad. The French census indicates that there are in France 66,000 foreigners, living mostly on independent incomes. The number of those that stay but a short time is certainly larger than this. This means an immense annual tribute paid by the respective home countries of these foreigners to France.

We must therefore conclude that the foreign trade of a country is in equilibrium, not when exports and imports are equal in value but when its credits and its debits are equal.

II. How the Balance of Accounts is Maintained

We must abandon the old and absurd idea that a country which imports more than it exports is rapidly approaching ruin. The problem, however, is somewhat altered by substituting the more.

important "Balance of Accounts" for the "balance of trade."

If a nation buys more abroad than it sells and has no other claims on foreign nations to restore the balance of accounts, it will be compelled to export its metallic money. To remedy the growing scarcity of metallic money it will probably resort to the issue of paper money. As this paper money cannot be employed to pay foreign nations, the country will be obliged to borrow abroad the sums that it must pay. Such a course as this must inevitably lead nations, as it does lead individuals, to bankruptcy.

Yet there are certain counteracting forces which operate very effectively. Persons who have payments to make abroad endeavour to settle them by bills of exchange payable in these foreign countries in order to obviate the inconvenience and expense of transporting gold and silver. But if a country owes more abroad than foreign nations owe her, it is clear that foreign bills of exchange will be at a premium. This premium will bring profit to those who have claims on foreign nations and will stimulate the exportation of goods. Inversely the necessity to pay this premium will place the importers in a disadvantageous situation and will discourage imports. The result will be an increase of exports and a decrease of imports—precisely the remedy best suited to the situation.

Nor is this all. Let us admit that the inequality of debits and credits involves a continual drain of money. The scarcity of money causes a fall in prices and this stimulates purchases by foreigners. At the same time the amount of purchases made abroad will decrease. In short, the situation just

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described tends to encourage exportation and discourage importation.

If paper money has been issued, the result is the same. Metallic money will be at a premium. Exportation is profitable because it brings metallic money which commands a premium. Importation, on the other hand, is slackened because, owing to the depreciated paper money, prices have risen.

To sum up then: there is a sort of automatism in the balance of accounts that tends to restore the equilibrium whenever it is disturbed. The current of trade cannot for ever continue in one direction. Sooner or later it must change.

III. The Advantages of International Trade

International exchange offers advantages similar to those resulting from personal and domestic exchange. It is strange that the advantages of International Trade have been considered from two precisely opposite points of view. The classical economists consider only *imports*. They regard importation as the *raison d'être* of international trade. Exportation is but a means. The less we give in exchange for what we want—so reason the classical economists—the more profitable is the transaction. According to the protectionists, and according to current public opinion, the advantages of international trade must be considered from the view-point of exports. Exports, it is held, constitute the real profits of international trade. Imports must be regarded only as a necessary evil. Exportation means increased wealth, importation means expense.

Both these opposite points of view are false. A great country cannot be likened to a person

carrying on a trade solely as a means of procuring what he needs. Inversely, the second point of view, which likens a great nation to a storekeeper who buys only in order to sell again, is no less erroneous.

In fact, the advantages of international trade are not susceptible of arithmetical calculation. They cannot be measured in money. The following are the advantages of importation :—

(1) *Additional well-being*. Only by importation can a country procure goods which cannot be produced within its borders.

(2) *Economy of labour*. This is true whenever goods are imported that could be produced at home only at a higher cost than abroad ; or, again, it may be to a nation's gain to obtain certain goods by importation even though it may be capable of producing them more cheaply, if by doing so it can devote its labour and capital to the production of goods in which its superiority is greatest.

(3) International commerce provides a kind of insurance against famines and against a multitude of economic evils.

As for exportation, the following are its advantages :—

(1) It utilizes natural resources and productive forces which, if there were no outlet for them, would be superabundant and therefore partially useless.

(2) International trade, by creating world-wide markets for goods, tends to develop the division of labour. It develops a nation's industry.

IV. Why International Trade necessarily is Detrimental to Some Persons

International trade is not always beneficial to everybody. One effect of importation is to

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economize labour and consequently to throw a certain class of labourers out of employment. It is true that an increase of imports gives rise to a counter-current of exports, but we must not forget that goods imported may represent a lower value than the corresponding goods supplanted in the home market. The additional exports from home necessarily balance the imports representing lower value. The final result would be a diminution of home products and a reduction in the amount of labour required.

This is not all. Those who have invested their capital in the production of goods which happen to be supplanted are not always able to shift their capital to other productive purposes. The result is ruin for the employer and idleness and poverty for the employees.

There are, however, attenuating circumstances. International trade may ultimately cause an increase in the amount of work in two ways :—

(1) The fall in prices resulting from free trade will cause an increase in consumption and consequently an increase in production. What the people save in the decreased price of one article will perhaps be used to purchase goods of home production. Even if the savings are used to buy foreign goods, it will be necessary to pay for this larger bulk of imports by exporting larger quantities of home products.

(2) The consumers are enabled to devote the amounts saved by a fall in prices to productive purposes. This means the employment of additional labour.

Exportation also may have undesirable effects. Countries which regularly export cereals may ultimately impoverish their soil.

V. The History of Protectionism.

During antiquity and the Middle Ages a few small countries acquired a monopoly of commerce by reason of their maritime position. Sometimes non-commercial peoples sought to attract foreign merchants by granting them certain privileges. However, they always required them to pay special taxes in exchange for the protection afforded. These custom duties, if we may apply this name to the early forms of compulsory tribute, were mere fiscal taxes.

In the sixteenth and seventeenth centuries the problem of customs duties acquired a different character, for the following reasons :—

(1) Because the great nations of Europe tried to form national markets.

(2) Because the great importance attributed to the precious metals led to the idea that a nation should buy as little as possible abroad in order not to be obliged to export metallic money.

(3) Because the opening of the world's great maritime routes led to competition between nations.

The mercantilists exaggerated the importance of money. This undue emphasis was not so absurd as some authors have maintained, for at a time when the great nations of Europe were being formed into powerful States, when taxation in money had just taken the place of taxation in products, a great increase in the amount of money in a country was indispensable. Soon afterward the desire to place the nation in a position of economic self-sufficiency began to receive the attention of statesmen. This ambition may be regarded as the original germ of

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the protectionist idea. Statesmen conceived the idea of employing customs duties as a means of excluding foreign competition. Customs duties lost their fiscal character and became protective.

In England, Cromwell, and in France, Colbert, were the first statesmen to devise a genuine protective system. Colbert formulated the principal objects of the protective system under three heads :—

(1) To prevent the importation of manufactured goods by means of protective duties.

(2) To favour the importation of raw materials by reducing all charges which might restrict importation.

(3) To encourage the exportation of national products, even by granting bonuses if necessary.

Colbertism reigned supreme until the economists made their appearance with their famous motto, *Laissez faire, Laissez passer*. In England the ideas of Adam Smith spread rapidly. Cobden began the remarkable campaign that was destined to overthrow the system of protection. He directed his attack solely against the protective duty on corn. Once this duty was abolished, all the rest of the English protectionist system fell to pieces.

In France Emperor Napoleon III. signed a commercial treaty with England. This celebrated treaty was followed by the signing of analogous treaties by most European powers. The era of Free Trade had fairly begun.

Yet this rule was of brief duration. The United States, after the Civil War, resolutely adopted a strong protectionist policy, and has since then continued it. France, under Thiers, tried to follow the example of the United States, and Germany, on the initiative of Prince Bismarck, inaugurated the return of European nations to a decidedly protec-

tionist policy. The prevailing tendency among Western nations thus appears to be decidedly in favour of protection. In economic theory there has been no such marked reaction. Nevertheless, the German economist List and the American economist Carey had already attacked the so-called Manchester doctrine at the very time when it was in the full tide of popularity. To-day the historical school insist that the commercial policy of a nation must be suited to its own particular conditions.

VI. The Doctrine of Protection

No question in political economy has stirred up more controversy than that of international commerce. Is not commerce between nations in all points similar to trade between individuals? If so, why do we need a special theory of international trade? To the classical economists the problem of foreign commercial policy is no problem at all. Exchange, they declare, is a form of the division of labour. Its advantages are reciprocal, and its utility is absolutely independent of the question whether or not those who engage in it are citizens of the same or of different countries.

But public opinion generally does not profess this superb indifference. It admits that free trade might even conduce best to the welfare of humanity. But nations are not accustomed to speculate on the interests of humanity in general ; they usually care for the interests of the particular country in which they live ; and this can hardly be regarded as a criminal offence. They hold that international trade does not confer equal and reciprocal advantages on both participants. It may lead to the enrichment of one nation and the ruin of the other. It must

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be regarded as a kind of warfare, a struggle for life among nations.

The arguments generally advanced in favour of protection may be summed up as follows :—

(1) International trade is likely to produce all the unfortunate effects that are inherent in economic warfare and competition—namely, the destruction of the weak. For instance, American manufacturers could not compete with European manufacturers. Should the manufacturing labourers of America take to farming and cattle-raising? Russia may be able to supply cheaper cereals to the world, and the Argentine Republic may prove to be superior in cattle-raising. In the production of raw cotton, America seems to possess natural advantages beyond contest. Shall the total population of the country, therefore, migrate to the Southern cotton fields? Will there be room for all American labour and capital in this single branch of production? Is it not obvious that the remuneration will be ridiculously small?

Should any country prove inferior to others in *all* branches of production, it would be dislodged from one occupation after another, and its only resource would be to transport its population and capital to those countries which had triumphed over it in the struggle. This is the logical outcome of free trade. Those who advocate it unreservedly forget that each nation has the determination and the right to live and to prosper.

An out-and-out Darwinist might sacrifice the individual to the interest of the race. But we cannot expect a nation to permit its own destruction for the sake of mankind as a whole. The part played by the nations of the world is by no means confined to that of economic productivity. Shall we incur the

risk of perhaps eliminating a new Greece from among the nations of the world simply because her arid soil may not enable her to produce so cheaply as her rivals?

(2) Let it be granted that each nation would succeed in finding some branch of production in which it could retain its superiority. Could this be called a desirable state of affairs? The free-trade school replies affirmatively. But in this case the national interest is entirely sacrificed to the supposed general interest. Such an ideal would involve the degradation of all nations. A country in which all persons were engaged in the same occupation would be a monstrous thing without intelligence and without vitality.

(3) The importation of foreign products, if not counterbalanced by a corresponding exportation of home products, is likely to ruin a country by removing its money. A country may in this manner be steadily and surely hastened toward bankruptcy. Political economy teaches us that imports inevitably lead to exports; but they do this by effecting a rise in the rate of exchange, and outflow of metallic money, and a general fall in prices. All these effects are very detrimental to a nation.

(4) Protectionists advance the fiscal argument that customs duties are the best kind of taxes because they are paid by foreign countries.

Nowhere has the problem of international trade been discussed more persistently than in the United States. A brief statement of some of the theories will be useful.

The national economy of labour consists in finding work for all those who are able and willing to work. The greater the variety of industries, the more the demand for labour.

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The national bent of the American character toward the mechanic arts, and the inventions that facilitate them, would, in the absence of manufacturing industries, find little or no vent.

Protection to industry is as much needed by the farmer as by the manufacturer. When a nation produces raw materials exclusively, and exchanges them for manufactured goods from abroad, one side pays for the transportation of bulky articles over great distances, while the other pays for the transfer of goods of the same value but more compact form. Protection to industry gives the farmer a near and steady market for his crops.

The "infant industry" argument advanced by Mill, although one of the ardent disciples of free trade, is frequently quoted in support of protection. "A country," says Mill, "which has skill and experience to acquire, may in other respects be better adapted to the production of certain articles than those earlier in the field. It cannot be expected that individuals should at their own risk, or rather to their certain loss, introduce a new manufacture and bear the burden of carrying it on until the producers have been educated up to the level of those with whom the processes have been traditional. A protective duty continued for a reasonable time will sometimes be the least inconvenient mode in which a country can tax itself for the support of such an experiment."

Protectionists go so far as to assert that the competition of home producers in the protected industry soon reduces prices to a point that is not above the ordinary level of profits in other industries.

Professor S. N. Patten has shown considerable ingenuity in the defence of protection. He distinguishes what he calls "static" societies from

“dynamic” societies. “The American people are in a dynamic state,” says he. “We must seek new opportunities for labour in which an increasing population can find employment. The American people should be more progressive than those of Europe. The soil we occupy is newer than that of Europe, the mines of which we make use are superior, and these conditions, coupled with the spirit of activity which fills the American people, should push us along into a higher stage of civilization much more rapidly than it is possible for the people of older civilizations to advance.”

Professor Patten does not believe that there is in political economy but one theory, the doctrines of which hold true for every civilization.

VII. The Doctrine of Free Trade

The free traders usually point out the contradictions involved in the various arguments just enumerated.

The essential features of the free trade argument may be summed up in the following five points :—

(1) From the view-point of consumption, protective duties tend beyond all question either actually to increase the cost of living or to prevent its decrease. Import duties cause an increase not only in the price of imported goods upon which the duty is levied, but in the price of all similar goods consumed within the country.

(2) From the view-point of distribution, protective duties create injustice, because their effect is to guarantee an increased income to the producer of protected goods.

(3) Even from the standpoint of national production these duties really do an incontestable injury

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to home production, by increasing the cost of raw material and all the equipment of productive enterprises. All protective duties invite capital away from industries in which a nation has unparalleled advantages, into industries where facilities are not so good.

(4) From the commercial point of view it has been noted that protective duties reduce imports, and thus simultaneously tend to reduce exports. Can anything be more absurd than to spend millions in digging canals, and then stationing customs officials at both ends in order to restrict the passage of as much merchandise as possible?

(5) From the point of view of industrial progress free traders hold that protective duties slacken progress by removing foreign competition.

VIII. The Relative Importance of Foreign and Domestic Commerce

The nations of the earth differ widely in area, population, the nature of their soil, the qualities of their inhabitants, &c. All these elements must be taken into account in the discussion of a commercial policy. The size of some countries is such that they could under no circumstances aspire to national self-efficiency in economic matters. The principality of Monaco with an area of eight square miles would scarcely act wisely in cutting off foreign trade.

Countries like the Argentine Republic and Brazil contain unlimited and varied natural resources, but their small population, a great part of which consists of uncivilized tribes, makes it impossible to carry out the division of labour to any great degree.

The domestic commerce of such nations as Belgium and Holland is of less importance than their foreign trade. The Dutch have become rich by importing and exporting goods, and their present principal source of gain is their forwarding trade.

On the other hand, large nations like Russia and the United States are evidently in a much more favourable position for the development of their economic self-sufficiency, and would suffer little loss from the interruption of international trade.

IX. Some Moderate Forms of Protection

There can be protection without protective duties by means of premiums to producers. Premiums on production must be distinguished from export premiums such as are employed by several nations in the case of sugar, and which produce the strange result that sugar is sold cheaper abroad by these countries than at home.

Premiums on production appear to be superior to protective duties for the following reasons :—

(1) Premiums can be graded at will, in such a manner as to protect those producers who most need protection, and not the others ; while customs duties establish an unequal protection, insufficient for the weak and unnecessary to the strong. Premiums can be adjusted to the cost of production, which is seldom exactly the same in any two establishments.

(2) Premiums permit the development of exportation and importation, and do not raise the price of goods. Customs duties involve an expensive administration, and give rise to smuggling.

(3) They are least likely to produce international conflicts.

(4) They do not increase the price of raw

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materials, and thus do not artificially raise the cost of production.

(5) Finally, in this system the public knows that it is paying for protection, and knows exactly how much it pays.

Some years ago there began a movement which, without advocating either protection or free trade, favoured reciprocity in the matter of customs tariffs. In England this is called *fair trade*, as opposed to free trade. It is said that free trade would be all very well if every nation adopted it ; but so long as other nations impose tariffs on our goods, we must be prepared to retaliate. Some of those who hold this view regard a tariff simply as a diplomatic means of securing mutual concessions. In such a case the question of tariff is political rather than economic. But if we regard this conception as a scientific theory, we find that it has no logical basis. For if the protectionist system is good, it should be adopted ; if it is bad, it should be abandoned.

Another form of moderate protection consists of countervailing duties. If it mean that those goods which within the country are burdened with certain taxes should be taxed to the same extent when imported from abroad, no one will challenge this principle of fiscal equality. But if it mean that whenever a country has the misfortune to be heavily taxed, it can lighten this burden by imposing high customs duties on foreign goods, it is utterly absurd.

X. Commercial Treaties

Between the system of free trade and that of protection there is fortunately another commercial policy which is founded on international agreement, and which may be called the *contractual system*. It

may be regarded as a true outcome of the spirit of international amity.

Commercial treaties offer the following advantages:—

(1) They guarantee the stability of tariffs during a definite period.

(2) They permit of a differentiation of duties, according to the country with which the treaty is made.

(3) They lead gradually to a more liberal régime and to the abolition or lowering of barriers between nations.

CHAPTER V—CREDIT

I. Credit is only an Extension of Exchange

CREDIT is protracted exchange—exchange which is not complete until a certain period of time has elapsed. Introduce the element of time into exchange and it becomes credit. Hence credit may be defined as the exchange of present wealth for future wealth. Sale on condition of payment at some future time, and loan, are the two essential forms of credit.

When payment is deferred the price of goods is likely to be higher than when cash is paid. The difference between the two prices is commonly called *discount*. In the case of loans the sum returned is somewhat larger than the sum loaned, the difference being called *interest*.

Credit involves the following characteristics :
(1) the consumption of the object sold or loaned ;
(2) the expectation of some new object of value to take its place.

II. The History of Credit

Credit was rarely employed as a method of encouraging production in antiquity and in the Middle Ages. In the loan contracts of the Middle Ages the Church fathers endeavoured to distinguish those cases in which loans aided production from those in which they were clearly unproductive, and in the

former case they admitted the legitimacy of interest, while in the latter they forbade it.

As a means of facilitating production, credit arose only with the invention of negotiable paper—credit instruments that may be bought and sold in the market. The use of negotiable paper dates probably from the thirteenth century. The most important kinds of negotiable credit instruments are bills of exchange and promissory notes. Bills of exchange are drawn by creditors, and promissory notes are made out by a purchaser or a borrower to his creditor. Both are transferable by endorsement, and they pass from hand to hand as easily as money.

In representing credit by negotiable instruments, there is a double advantage. The person who buys on credit has some capital at his disposal, and the seller if he wants money, before the bill of exchange or promissory note is due, has simply to sell it, or in the language of the bankers, negotiate it.

III. Can Credit Create Capital?

Credit is not a factor of production. It is a particular method of production, like division of labour. It simply transfers wealth from one person to another. As J. S. Mill says, "Credit is simply permission to use the capital of others."

As negotiable paper represents loaned capital, the act of lending appears to double the amount of capital. From the subjective or individual point of view this is true. The paper is capital for the lender but not for the nation. Mr. Macleod's contention, that credit instruments are real wealth, can hardly be maintained. If every credit instrument really constituted wealth, it would be possible to double the wealth of a community simply by

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each citizen lending his estate to his neighbour in exchange for a note. Credit does not create capital, but renders eminent services to production by enabling us to use existing capital to the best possible advantage. It has been well said that credit transforms latent capital into active capital.

IV. The Function of Banks

Borrowing and lending are the two fundamental transactions of all banking business. The sums which the banks borrow are usually obtained through deposits, and their loans are usually made in the form of discount; they are therefore commonly called *banks of deposit and discount*. Some banks perform a third function, namely, the issuing of notes. This operation is not essential to banks; often it is a privileged function belonging only to certain banks known as banks of issue.

V. Deposits

The banker's first task is to get capital from others. If he carry on his business only with his own private capital, or with that of a group of capitalists, his profits will be small and his services of little importance to society.

What the banker tries to get hold of is the circulating capital which people keep with them. In all countries there is a large amount of capital of this sort—capital which does nothing, but which is simply kept in readiness for the time when it shall be employed. The banker takes charge of these funds, pays a low rate of interest, and performs the additional service of being the treasurer of the depositors. Whenever a person has to pay

any one he sends him to the bank to receive payment upon presenting a cheque or written order drawn on the bank.

VI. Discount

When this floating capital has been borrowed by the bank at a low rate, the next step is to turn it to account by lending it to the public. The banker cannot lend money for long periods. He holds the money on trust and may be required to refund it at a moment's notice. The deposits must be kept within easy reach.

When a merchant has sold goods on credit and happens to require money before the time for payment is reached, he turns to the banker. The latter will advance the sum that is due, minus a small amount which constitutes the banker's profit. Thus the banker acquires the merchant's claim on his purchaser, *i.e.*, his bill of exchange or promissory note. He keeps this bill or note until the time when it falls due, whereupon he collects it of the debtor. This transaction is called *discounting*. The bills negotiated by the bankers are usually payable in three months, but it is not generally necessary to wait even for that time.

It is evident that in periods of crisis the banker must incur considerable risk. The money borrowed by the bank is payable on demand, whereas the money lent can be claimed only after a certain period. There are times when this difference may lead to bankruptcy.

In order to face any demands which may arise, banks take care always to have a certain cash reserve on hand. Generally a reserve of from 15 to 25 per cent. of the deposit is sufficient to meet all demands.

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A bank's reserve should be larger whenever its credit is poor or whenever it has many large depositors. It should strengthen its reserve particularly during commercial crises and on the advent of new issues of Government loans.

The term *deposit* is applied indifferently to credit balances originating in deposits of money or to those having their origin in the discounting of notes, and may therefore be defined as the aggregate amount standing to the credit of the customers on the banker's books.

Banks also lend money in other ways: (a) By making advances on securities. (b) By granting an open credit to their customers, who are thus allowed to withdraw more money than they have deposited. As such uncovered loans or overdrafts are very risky, many banks refuse to transact them.

The following are some of the terms employed in the banking business:—

Promissory notes are sometimes made out for future or fictitious transactions. They are called *accommodation bills*.

Some banks authorize persons to draw a maximum amount of money from the bank within a given time, interest to be paid for the time that it is kept out. These are loans on personal security, never less than two names being required, and are called *cash credits*.

Bills of exchange or drafts are sometimes accompanied by *bills of lading*, warehouse receipts, &c., which are specific titles to property, the bank having a lien on the property until the bill is paid. These are exceptionally secure bills and command a lower rate of interest than is usually paid.

Letters of credit are instruments of writing issued by a bank, authorizing the holder to draw upon

the issuing bank or upon some affiliated institution, at sight or otherwise, and within a definite period, a sum or sums of money not exceeding a specified aggregate amount. The letter always indicates how much has been drawn and how much credit remains unexhausted.

VII. The Issue of Bank Notes

Bankers have conceived the ingenious idea of actually creating the capital they need, by issuing simple promises to pay, *i.e.*, by issuing Bank Notes. Although a bank note is only an instrument of credit like a bill of exchange, yet it represents a far more convenient form of credit claim. It is superior to most credit papers for these reasons :—

- (1) It is transferable to bearer, just like coin.
- (2) It is payable at sight.
- (3) It is always payable on demand, whereas negotiable paper may lose its value at the expiration of a certain period.
- (4) It is always for a round sum.
- (5) It is issued and signed by a well-known institution.

Bank notes are fiduciary paper money. It goes without saying that banks derive great benefit from the emission of notes. It provides them with the resources necessary for extending their transactions. The capital obtained by means of notes is far more profitable to them than what they receive in the form of deposits.

We must not forget, however, that the sum total of bank notes in circulation represents a debt that is payable on demand. The bank consequently is exposed to a twofold peril : it may be called upon at any time to refund its deposits and to cash its

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notes. The necessity of a cash reserve becomes therefore still more imperative.

VIII. Differences between Bank Notes and Paper Money

(1) It is a matter of principle that bank notes should always be convertible, whereas paper money is not.

(2) Bank notes are issued in the course of commercial transactions, and only to the extent required by these transactions ; whereas the issue of paper money by the Government is for the purpose of meeting its expenses, and has no other limits than the financial necessities of the moment.

(3) Bank notes are issued by a Corporation whose principal object is to carry on business, and whose principal care is to safeguard its credit.

For these reasons bank notes are superior to paper money issued by Government. Bank notes may, however, approach paper money by losing one or more of the characteristics mentioned above.

(a) Bank notes may acquire forced circulation for a time. Even in this case there still remain two other differences between bank notes and paper money.

(b) It may happen, however, that instead of being put into circulation in the course of commercial transactions, bank notes are merely issued for making loans to the Government. In this event, the second guarantee likewise disappears. The issue of notes then has no other limit than the needs of the Government.

Yet even in this case the third guarantee still subsists, namely, the definite identity of the Corporation issuing the notes. This of itself is still

sufficient to make bank notes much less subject to depreciation than paper money.

IX. The Rate of Exchange

Bankers who deal in bills of exchange buy them of persons who produce them, especially from merchants who have sold goods abroad. If the creditors need money before the bills fall due, or simply because they find it inconvenient to send the bills abroad for collection, they sell the bills to the banker. Bills of exchange are eagerly sought by all those who have payments to make in foreign countries, particularly by merchants who have purchased goods abroad.

It goes without saying that the degree of confidence which can be placed in the debtor and the period of time which must elapse before the bill is due affect the value of the bill. But apart from these self-evident causes of fluctuation, the value of the bill varies from day to day according to changes in the demand and supply. These variations constitute what is called the *rate of exchange*.

If the claims of a country on foreign countries are less than its debits abroad, there is not enough commercial paper for all those who want it. Foreign bills of exchange rise in value. They are above par; in other words, they command a premium.

Conversely the bills fall below par when the claims of a country are more than its debts.

When in any country paper payable abroad is quoted above par, the rate of exchange is said to be unfavourable to that country. If the expression means that rate of exchange is unfavourable to

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those that buy exchange, we must add that it is favourable to those that sell it. The term really means that the rise of the rate of exchange is an infallible premonitory sign of the exportation of coin. Conversely, when foreign paper is quoted below par we say that the rate of exchange is favourable. We mean that the balance of accounts will be in our favour, and we must therefore expect the importation of coin.

We must not attach too much importance to these expressions. For a nation to send money abroad or to receive it from other countries, constitutes neither a great danger nor a great advantage. But from the banker's point of view this situation is of very great importance ; for if money must be sent abroad, it will probably be taken from the bank.

Variations in the price of exchange are confined to narrower limits than the price of any other commodity. This is due to two causes.

(1) Bills of exchange on foreign countries are sought by those who want to send them abroad merely to save the expense of shipping coin. It is obvious that if the premium for foreign exchange is higher than the cost of shipping and converting coin, there will be no inducement to buy exchange. Conversely, the merchants who are creditors of foreigners will surely adopt the course of collecting their bills abroad rather than sell them at too low a price. Trade in foreign exchange has no other purpose than to economize the cost of shipping and changing money. As the cost of carriage is very small, fluctuations in the rate of exchange will be confined within rather narrow limits.

(2) These fluctuations are again limited by another influence which is both more remote and more subtle. A rise in the rate of exchange acts

as a premium on exports. The increase of exports gives rise to an increase in the amount of bills of exchange, and consequently the value of these bills falls until foreign exchange is at par.

If foreign exchange falls below par it will tend to reduce exports, and thus reduce the supply of foreign exchange until its value has again reached par.

In some exceptional cases the rate of exchange may fluctuate greatly. Such cases are the following :—

(1) When a bill of exchange is payable at a place that is far distant or inaccessible, the cost of shipping money would be great, and fluctuations in the rate of exchange are likely also to be considerable.

(2) When we have to do with a country whose money is depreciated, fluctuations in the rate of exchange may become excessive and appear to have no limit at all.

N.B.—It is a mistake to suppose that the Hindoo farmer who sells his wheat for three shillings a bushel in London can negotiate his bill of exchange on London (payable in English gold money) for twice its value in Indian silver money.

The Indian rupee has acquired an artificial value after the closing of the Indian mints to the public. The depreciation in the value of silver has practically no effect on the value of the Indian coin. Conversely it is by no means necessary for an Indian merchant to ship rupees to foreign countries in case he has to make a cash payment. He will find it cheaper to send gold or silver abroad than to send rupees or convert them into silver by means of a melting pot.

(3) Finally whenever the debtor finds it difficult

to obtain gold, the rate of exchange may rise far above par.

X. A Rise in the Rate of Discount

Banks incur the risk of being obliged to redeem a great quantity of their notes whenever considerable amounts of money must be paid to foreign nations. This situation may become perilous for a bank if its reserve, and especially its gold reserve, is short. Fortunately the banks are forewarned of this contingency by a rise in the rate of exchange. When the rate of exchange becomes unfavourable, the bank must adopt the measures necessary either to increase its reserve, or to decrease the quantity of its notes in circulation or of its other demand liabilities. It is within the power of the bank to issue no more notes, either in the form of advances or in the form of discounts. Such a measure would, however, be too radical. It would provoke a terrible crisis in the country, and also work great injury to the bank itself. The bank may bring about the same result in a less violent manner by raising the rate of discount. This measure has beneficial effects on the country. It gives rise to an influx of money from abroad, or at least prevents the outflow of a nation's own supply of money.

The first result of a rise in the rate of discount is the depreciation of all commercial paper. The bankers of all nations, especially the arbitrage brokers, will purchase bills of exchange in this country because they can be bought here at a low price.

The second result is the depreciation of all stock-exchange securities. Bankers frequently employ international stock-exchange securities, in place of

commercial paper, to pay their debts abroad. Business men who cannot negotiate their commercial paper prefer to get money by selling whatever shares they possess. Hence these stocks fall in value. This gives rise to an increased purchase of them by foreign capitalists.

Finally, if the rise in discount is great and sufficiently lasting, it will cause a general fall in the price of commodities. This stimulates purchases from abroad and makes the country a creditor of foreign nations.

All these effects may be summed up by declaring that a rise in the rate of discount creates an artificial scarcity of money, and thus involves a general decline in values.

XI. Some Special Forms of Credit

(1) *Land credit.* It is based on land as security and takes the form of a mortgage. From the standpoint of the lender, it possesses an advantage—namely, an absolute security due to the fact that land cannot be destroyed or stolen. Such loans, however, possess great disadvantages. They burden the borrower with a comparatively high rate of interest. The lender is unable to enforce payment readily. His claim is not easily sold, and he may be obliged to have recourse to seizure and ejection.

In some countries mortgages are made negotiable simply upon indorsement. But the holder of a mortgage cannot negotiate it as easily as commercial paper. A mortgage will always, to some extent, partake of the immobility of the land upon which it is based.

In France and Germany there are banks of a special nature, known as land-credit societies. These

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societies play the part of intermediaries between capitalists and landowners. They offer important advantages to both parties concerned. To the capitalists they offer credit instruments that are quite as safe as mortgages, but which are much more easily negotiable because they are guaranteed by the entire assets of a society. To the landowners they offer the following three advantages: (*a*) the loans they make are for long periods; (*b*) repayment is effected very gradually; (*c*) they exact a comparatively low rate of interest.

It is difficult to see the usefulness of land credit, no matter what ingenious forms may be given to it. Loans by way of mortgages often end disastrously in the case of small farmers. Something like the Homestead Laws of the United States should be adopted in every country for the benefit of small farmers.

(2) *Agricultural credit.* The farmer continually needs funds to meet running expenses. It is the object of agricultural credit to provide capital for this purpose. Agricultural credit is not based on land itself. It is secured either by the equipment of the farm or by the personal solvency of the debtor.

Mutual credit societies among farmers have made much progress in Germany. The farmers lend money to each other through the medium of their societies, and employ their collective credit to obtain loans from outsiders upon very favourable terms. These societies present the following features: (*a*) Members, as such, make no payment to the organization as there are no shares; (*b*) they receive no dividends; (*c*) the members are liable to the extent of their property for each other's debts.

(3) *People's banks.* It is a familiar remark that "only the rich can borrow." Yet the poor also may have need of credit, even more than the rich. An isolated labourer cannot furnish sufficient guarantee for a loan. But if labourers are grouped in an organization, and held together by the ties of collective responsibility, they will find it easier to obtain credit. Such co-operative banks, the essential characteristic of which is the unlimited liability of all members, have achieved extraordinary success in Germany. The heads of these associations hope that they will enable small-scale industry to compete with the larger industrial concerns. This will be an important result, but up to this time credit granted to labourers for productive purposes has accomplished nothing of importance.

(4) *Building associations.* In England and the United States Co-operative credit has been confined almost exclusively to the so-called building and loan associations, the primary object of which is to enable working men to acquire homes for themselves, the property being mortgaged to the association until the amount advanced is fully paid.

The building and loan association is practically a Co-operative savings bank. Its funds are used by the depositors themselves, and not placed at the service of business men. Every member has a voice in the management of the association and shares in the profits. A board of managers has charge of supervising the business of the association. A fraction of the capital stock is issued in what is known as a *series* and paid in monthly instalments, commonly called *dues*. Whenever the monthly payments, plus the accumulated profits, equal the face value of the shares, the series is withdrawn. The money obtained by the association

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is lent to shareholders who desire to buy or build homes. No member can borrow more than the face value of his shares.

XII. Free Banks

The economists of half a century ago upheld the doctrine of Free Banks quite as strenuously as the doctrine of free trade. They insisted that there should be both free competition and free issue.

(1) The argument advanced for free competition in the banking business was the classical plea that monopoly means dearth, whereas competition means cheapness.

We may reply that there are numerous exceptions to this economic principle, even with regard to the production of ordinary commodities; and in the present case it is of particularly doubtful validity. Moreover, the problem of monopoly *versus* competition does not arise with reference to banking operations in general, but with reference to the issue of notes. This problem concerns the general public much more than the commercial classes. The right to coin money is reserved by the Government. It is perfectly reasonable for the Government, when it does not exercise the right of issuing notes, to confer it upon such institution or institutions as command the confidence of a nation.

When there are many banks of issue, there is likely to be a great variety of bank notes.

(2) As regards the unrestricted issue of notes, the stock argument is that there can never be any danger of an excessive issue of notes. The reasons given for this are three in number:—

(a) Bank notes are issued only in the course of

banking operations—*i.e.*, by way of discounts. The quantity of notes that the bank can issue depends on the amount of commercial paper presented for discount. Issues are thus regulated by the needs of the public, and not by the wishes of bankers.

(*b*) Again, bank notes circulate only for a short time. The bank will, in the course of a month's or a year's business, take in about as many notes as it issues.

(*c*) Finally, even admitting that the bank could issue an excess of notes, it will be impossible to keep them in circulation ; for if too many are issued they will necessarily be depreciated, and the holders of notes will bring them to the bank and demand payment.

The above three arguments certainly contain an element of truth. But if an unscrupulous bank should aim solely at attracting customers, it could, by sufficiently lowering the rate of discount, largely increase its business, and thus augment the amount of its notes in circulation. No doubt depreciation will take place, but it will require several weeks. It will be, perhaps, too late when the notes are returned, and the bank may not be able to redeem them.

XIII. The Organization of Banks

The system of free competition in the issue of bank notes and the total absence of restrictions is practised almost nowhere. Although legally free competition prevails in Scotland, there are in reality only a few banks which possess the right of issue. There is no regulation of issues, but a very effective guarantee exists in the fact that all shareholders are liable without limit for all the obligations of the bank, including the notes issued by it.

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Everywhere else a system of monopoly or of restriction and regulation by law has prevailed. In most countries a combination of both systems has been adopted. The experience of America is sufficiently varied to exemplify the nature of the difficulties encountered in the organization of banks of issue.

Early American banks. The main business of the early American banks was to issue circulating notes. The right to issue them existed without legislative authorization.

The two United States banks. The charter for the first Bank of the United States was granted by the Congress for twenty years. The Government pledged itself to grant no other charter during the continuance of this one, the notes of which were receivable for all public dues. The bank maintained a high standard of commercial honour. Unfortunately the charter was not renewed for political reasons. The State banks now held the field alone. A short time after the beginning of the second war with England nearly all the banks except those of New England suspended specie payments. As a result the second Bank of the United States was chartered on the same plan as the first bank of the same name. This bank also was drawn into politics. The charter expired, and the Congress refused to grant a new one.

Two important banking experiments were tried in New York, known respectively as the *safety-fund system* and the *free-bank* or *bond-deposit system*. The first of these was practically a mutual insurance of the banks for the protection of their creditors. The law also provided for the appointment of three commissioners to examine all the banks three times a year. Any three banks might call for a special

examination of any bank in the system. There were many failures, and after the expiration of the charters of these banks the national bank system was established.

The second New York experiment was more radical than the first. A law was passed enabling any person to engage in the business of banking and to circulate notes on condition that the notes were secured by deposits of such stocks as were approved by the State Comptroller. The Civil War broke out and the National Bank Act soon afterward superseded all other systems.

The national banking system. The financial necessities of the Civil War made it desirable to place large Government loans upon the market. The secretary of the Treasury advocated a system of national banks whose note issues should be secured by an abundant deposit at the Treasury department of United States bonds. In order to give these banks a practical monopoly of the right of issue, the State banks were made to pay a prohibitive tax on their notes.

Each national bank, now, besides being allowed to carry on the ordinary business of a bank, is allowed to issue national bank notes. The stock-holders are liable for the debts of the bank up to double the par value of their stock. Each bank is required to report its condition five times a year. It must invest in United States bonds a sum of money equal to at least one-fourth of its capital.

The national bank notes are not legal tender, although the Government will receive them for all taxes except duties on imports. Each national bank is required to receive the notes of every other bank at par value, and to redeem its own notes on demand in legal tender money. It is also required to keep

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a reserve of lawful money. One great merit of this system is the unification of banking in all the States.

The Bank of England. In 1694 the English Government required a loan to continue the war against France. The subscribers to this loan were formed into a Chartered Company known as the Bank of England, which was given the right to issue interest-bearing notes to the amount of the loan. Three years later another loan was made, and the bank was authorized to issue demand notes, payable to the bearer, for a total amount equal to the new loan. A few years later Parliament decreed that no other corporation should exercise the right to issue demand notes in England. In 1826 the monopoly of the bank was relaxed and the privilege of note issues was granted to joint-stock banks at a distance of sixty-five miles or more from London.

In 1833 Parliament passed an Act making the notes of the Bank of England, so long as they are redeemed in gold on demand, legal tender at all places in England and Wales except at the bank itself.

Sir Robert Peel's Act of 1844 made the issue of notes automatic. The Bank was divided into two distinct departments. One of these departments was charged with banking operations, the other was entrusted with the issuing of notes. The sum of £14,000,000 of securities, including the Government's debt to the bank, was transferred to the issue department, which was allowed to turn over to the banking department £14,000,000 of notes. Beyond this sum the issue department could issue notes to any person only in exchange for gold coin or standard bullion. If the banks

having the right to issue notes should cease to exercise the right, the Bank of England might be authorized to issue two thirds of the amount so withdrawn by adding an equivalent sum to the government securities in the issue department. The amount of the bank notes has been thus raised to £17,000,000.

During the crises of 1847, 1857, and 1866 this system was found wanting and the restriction on the note issues had to be suspended.

It cannot be said that the monopoly system prevails in England. Nor is the English system one of free competition. But when none of the provincial banks of issue are left, the Bank of England will possess a virtual and legal monopoly of the right of issue.

The Bank of France. The Bank of France has the sole right to issue notes. It is not a Government bank but a stock company, only, instead of being managed wholly by the stock-holders, its governor and vice-governor are appointed by the Government. The following are some of the most important conditions which the bank has to observe :—

(1) The bank is permitted to discount only such bills as bear three signatures, and are drawn for ninety days at the most.

(2) It is not allowed to pay interest on its deposits.

(3) It can make loans on certain kinds of securities, but it must not permit customers to overdraw their accounts. To the Government it is obliged to make certain uncovered loans.

(4) It cannot issue notes beyond a stipulated amount.

(5) It is obliged to share its profits with the

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Government, according to a somewhat complicated method of calculation.

Its true function as a banking institution is, as some have expressed it, that of a bank of banks and a treasurer for other institutions. It may be said that the whole credit of the country depends indirectly on the reserve of the Bank of France. The bank has to keep an enormous reserve.

Whether the system adopted by a nation be that of competition or that of monopoly, some arrangement is always devised to ensure the redemption of the notes. Four systems may be distinguished :

(1) The first consists in limiting the amount of the notes in circulation by the amount of the reserve. This system is applied to the Bank of England. The bank can issue notes only to the amount of its reserve plus £17,750,000.

(2) The second method consists in fixing a certain ratio between the amount of the reserve and the amount of the notes issued. This rule is observed in Belgium and Germany. The system is more elastic than the preceding one, but leads to the same result.

(3) The third plan consists simply in fixing a maximum of issue. This system is practised in France.

(4) The fourth plan is to compel banks to secure their note issues by reliable instruments of value, which are generally Government bonds equal in value to the notes. This is the system employed in the United States.

No system thus far devised offers an absolute guarantee for the redemption of notes. It is impossible to combine the advantages of credit and those of strictly cash transactions.

BOOK IV. DISTRIBUTION

PART I. THE VARIOUS SYSTEMS OF DISTRIBUTION

CHAPTER I—THE PRESENT SYSTEM

I. How the Distribution of Wealth is Effected

CONSTANTLY wealth is being consumed or withdrawn from circulation ; constantly wealth is being produced and put in circulation. The whole question of distribution is to discover whether each person withdraws from the social product a value equivalent to that which he contributes.

The classical economists hold that in a society based on the liberty of labour and the absolute freedom of contract every one receives the just and exact equivalent of the wealth he creates. Each of us offers for sale the commodities he possesses. These products or services are sold at a price fixed on the market by the law of supply and demand. The public determines the share that each of us shall receive by the price it consents to pay for our product or services. The classical economists point out, moreover, that competition always tends to correct any inequalities that may arise. If any industry realizes excessive profits, a horde of rivals will engage in that industry and thus reduce the profits. Thus the value of every commodity tends

to be regulated by the trouble and expense necessary to produce it.

II. Why the System of Distribution does not seem Just

As a scientific explanation of what takes place, the classical explanation is good, but as a justification it is poor. A famous musician is often paid ten thousand times as much as a miner for a day's work. Does the former render society a service ten thousand times greater than the latter? The classical school would answer in the affirmative; but if this be true, then the products, services, and labours that are most useful to mankind may possess almost no exchange value. On the other hand, such labour or acts as provide the most immoral pleasures may be purchased at extravagant prices. The law of value has nothing to do with the question of justice or injustice.

Finally, the law of free competition, which, according to the classical economists, acts as a corrective, never operates fully.

We must, nevertheless, admit that the present method of distribution, founded on free competition and the law of demand and supply, accomplishes fairly well two things which are of capital importance.

First, it stimulates productive activity, Secondly, it violates no one's right of free initiative. The distributive process, founded on free competition, does not call for the intervention of a distributive authority. Admitting for a moment that we might discover the ideal rule of distributive justice, it would require the intervention of some authority to apply it. Again, the authoritative regulation of

distribution necessarily involves the regulation of production and labour. It would be too dear a price to pay for a more equitable distribution if we were obliged to sacrifice liberty to attain it.

III. The Origin of the Right of Property

The classical economists define property as a man's right to the product of his own toil. Lawyers have been more cautious; they do not attempt to justify private property. Their usual definition of property is to the effect that it confers the possession, use, disposal, and enjoyment of a thing. There is no mention of labour in these definitions. In most legal systems occupancy is regarded as the primary fact underlying the right of property. As it is not possible to go back to the beginning, it may be said that property is usually based on prescription—*i.e.*, long-continued and uninterrupted possession. We must therefore regard private property as a historical fact.

IV. The Evolution of the Right of Property, with Regard to its Object

There was a time when the scope of private property was confined to a few objects. At first it comprised slaves and women. Later, it came to include home. Private property in land was established very gradually.

Different kinds of property have successively played a dominant part in the history of mankind. Private property has now been extended to the so-called invisible wealth—that is, credit claims or shares. Works of literature, science, and art have become the objects of property under the names of Copyrights and Patents.

V. The Evolution of the Right of Property, with Regard to its Attributes

The Right of Property has two characteristic attributes: perpetuity and free disposal.

Inseparably connected with the perpetuity of the right of property is the right of legacy or inheritance. From the view-point of the distribution of wealth, the perpetuity and inheritability of property result in the ownership of wealth by persons who have not produced it.

The right of free disposal, which confers upon ownership an absolute character so inherent that we can scarcely conceive of ownership without it, did not always exist.

Probably the order in which the right of private property acquired its essential attributes was as follows:—

(1) The first property right was that of exploiting one's possessions—that is, making them yield something for the owner by means of the labour of others.

(2) The right of gift—at least, in the case of movable objects—seems to have been anterior even to the right to sell.

(3) The rights to sell and to rent seem to have sprung up much later.

(4) The right to bequeath was even slower in becoming a part of the right of property.

Inheritability, gift, and legacy, taken together, make it possible to possess wealth without having performed any labour.

The power to lend, to lease, or to rent property gives rise to a division of society into two classes—creditors and debtors. It results in the creation of

a new way to live without working, viz., living on an independent income.

The right to utilize property exploitatively gives rise to another division of society into two classes - wage-workers and employers. It prepares the way for the conflict between labour and capital.

The right to sell transforms the ownership of the product into the ownership of the value of the product.

Three of these effects of the right of private property appear particularly objectionable from the standpoint of social justice. The first is the extreme inequality of wealth, the second is the right to be idle, the third is pauperism.

VI. The Inequality of Wealth

The inequality of wealth has led the poor to complain bitterly, and has given rise to socialism. Without doubt, this state of affairs is due partly to an unworthy feeling of envy, but the following circumstances appear to justify the feeling that social justice is violated :—

(1) The present inequalities of wealth do not appear to be natural, but artificial. Differences of wealth do not seem to be gifts of Nature, but the unforeseen results of a specific social organization. This is probably true of countries like England ; but it cannot be said of democratic countries like France or the United States that the wealthy are made rich solely by the laws.

(2) Natural inequalities harm no one. The possession of intelligence by a few does not make the others stupid. It is held, on the other hand, that the wealth of the rich is created by plundering the poor.

Certainly we cannot deny that all great fortunes are created by taking a part of the proceeds of the labour of others, but this appropriation is not necessarily robbery. It is nevertheless true that economic inequalities are much more pronounced than natural inequalities.

(3) Finally, this inequality of wealth becomes more unbearable when we consider that all the other inequalities which formerly separated men are gradually being abolished.

An investigation of these three objections does not lead to the conclusion that all inequality of wealth should be abolished. In the first place, it would be impossible to do this. In the second place, it does not seem desirable to do away with the inequality of wealth. Economic inequality acts as an incomparable stimulus to production. It keeps all men on the alert, from the bottom to the top of the social ladder, by offering the prospect of gradual advancement.

Yet we must admit that perpetual inequalities are extremely unfortunate, because they create class distinctions. Economic extremes engender two evils--indolence and pauperism, both of which lead to unproductive consumption.

VII. The Right to be Idle

In all societies there are persons, usually a minority, who do nothing. It is among people of this class that we find the largest incomes. Not only are these incomes often larger than those due to labour, but they possess the great advantage of being more regular. When a man possesses this advantage, he is said to live on an independent income.

An investigation of the origin of the various classes of income would establish the principle that the man who receives an independent income lives on the product of past labour. When this income may be regarded as the result of his own past labour, there can be no reasonable objection to it ; but when this past labour was the labour of others, the question becomes a more embarrassing one, and implies the solution of the difficult problem of inheritance.

From the purely economic point of view, this problem is easy to solve. Money has been compared to orders or claims to goods. Suppose that a man has earned by his labour a large number of these orders. If he does not care to use them himself he can transfer them to some one who will use them in his stead. Obviously, he has a perfect right to do this.

From a moral point of view, the problem is a more difficult one. It may be maintained that the goods which the idle property-owner consumes from day to day are the products of present labour, and justice would seem to demand that in exchange for what his fellow-creatures are doing for him he should be required to do something for them.

It cannot be denied, however, from the historical point of view, that the so-called idle rich have in the past performed a genuine social function of the very first importance, namely, the creation of arts, sciences, literature—everything, in a word, that constitutes civilization. But will this always be the case? Socialists assure us of the contrary. They hold that all the necessary and desirable social functions can and will be performed and rewarded even in modern democratic societies.

There is no doubt that we should endeavour to

assure to all persons a certain amount of leisure ; then there will be no excuse for the existence of a special class of idle rich.

VIII. The Right to Relief.

The inequality of riches not only creates a class of idle property-owners, but it also gives rise to a numerous class of idle dependents who cannot or will not live by their own labour.

There are three possible reasons why people do not work :—

- (1) They may not have strength to work.
- (2) They may not be willing to work.
- (3) They may be unable to find the means or the opportunity to work.

Society cannot escape the problem of making some provision for them.

The first class should be taken care of, because society as a whole should feel a certain degree of responsibility for all its members.

Society must care also for the second class, because it constitutes a public danger. The army of crime is recruited from this population of vagabonds, and it is more prudent and more economical to reduce crime than to punish it.

Society should also give attention to the third class, because it is to some extent responsible for their misfortune. The very law of progress causes unemployment and crises. It is therefore just and proper that society, which profits by each step of economic progress, should also bear its unfortunate consequences.

The claim which these various classes have upon society may be called *the right to relief*. Socialists prefer to employ the term *right to existence*, or,

when speaking of able-bodied dependents, *right to work*. All these terms have the same meaning.

We must recognise that the expression "right to relief" implies not only a natural but a legal obligation on the part of society. The expenses necessary to accomplish this object should form a part of the regular expenditure of the nation or the municipality. When this is the case we speak of legal relief as opposed to optional relief.

The classical economists have pointed out the dangers of such relief. Malthus says that "the number of dependents tends to increase in direct ratio to the aid they count upon receiving." The reasons given for this formula are the following:—

(1) The right to relief puts a premium on improvidence.

(2) The right to relief causes a rapid increase of population among the dependent classes.

(3) The right to relief burdens the productive classes of society for the sake of the unproductive classes.

The above arguments show that we must be careful in the administration of relief. Nevertheless we must not ignore the bond of social solidarity which unites all mankind.

No doubt the prospect of regular help from the public Treasury may tend to curtail productive activity and saving. But the same may be said with regard to the wealthy classes which we have considered in the preceding pages. We must admit that the birth-rate is higher among dependents than among the classes that support themselves, but if the children of the former can be made useful citizens, they should not be regarded as a danger but a gain, especially in view of the fact that among the rich the birth-rate is rapidly decreasing.

It is true, finally, that the maintenance of all diseased, infirm, or defective persons may be prejudicial to the economic evolution of society. But moral advancement is quite as important as economic progress.

We must, furthermore, bear in mind that a well-organized system of public relief does not increase the number of dependents. It is said by socialists that the day of private and public relief is past, and that its place will be taken up by insurance founded either upon mutual association or upon Government co-operation. Certainly this would be desirable.

CHAPTER II—THE SOCIALISTIC SYSTEMS

THE quest of a better method of distribution in place of the present unjust one has given rise to the numerous systems of Socialism. Some socialists would transform the entire system of production and exchange. Fourier cares less for the means of effecting a better distribution of wealth than he does for the best way to increase the supply of wealth. Marx regards all systems of distribution, past or present, as the necessary outcome of prevailing methods of production. Yet, since all these systems of socialism are phases of the perpetual war of the poor against the rich, they are included under the heading "Distribution."

We shall examine the principal systems of socialism, especially those which advocate any of the following four principles of equitable distribution :—

- (1) Every one should have an equal share of the social product.
- (2) Each person should receive according to his wants.
- (3) Each person should receive according to his merits.
- (4) Each person should receive according to his work.

I. Equal Sharing

This childish system of distribution seems to have prevailed in the very remote past. In primitive

communities such a system as this was possible. But in modern societies it would be absurd. There is still a trace of this idea at the basis of socialistic systems. They take it for granted that there is more than enough wealth to satisfy the wants of all. We need only take back that part of the social product which the rich have unjustly appropriated. Revolutionary socialists would do this by expropriation; moderate socialists would accomplish it by means of progressive taxation.

In all countries, however, the rich constitute a small minority. Even if the incomes of the rich were divided among all the people no one would thereby become opulent. In fact, there is not enough wealth for distribution.

II. Communism

As every kind of division would simply give rise to new inequalities, why not regard all wealth as belonging to everybody? Let every one consume according to his wants.

Such is the simplest and the oldest of all systems of socialism. But this system had already begun to be somewhat out of date and ridiculous, when, quite recently, the anarchists took up the theory and gave it a new lease of life.

"To each according to his wants" would be the most agreeable rule. But in that case wealth would necessarily have to exist in unlimited or at least superabundant quantities. Unfortunately this is not the case. Hence, some method of sharing must be devised. But the social plan of the communistic anarchists involves the suppression of all authority and all government.-

We do not hold that the realization of com-

munistic societies on a small scale is impossible. There are such societies in the United States. Let us examine the conditions of their relative success :—

(1) These communities must be very small. Fourier fixed the maximum number at 1,500. Owen fixed the number between 500 and 2,000. Anarchists would suppress the central Government, and the nation, and base their society on the independent commune.

The political evolution of modern society points to centralization. Even if it were possible to substitute independent communes for the central Government, the inequality of individuals would simply make way for the inequality of local groups.

(2) These communities must be subjected to very strict discipline. Experience shows that the tendency is for members to try to evade the rules and to shirk the burdens put upon them. The practice of the communistic régime, when combined with the anarchistic ideal involving the abolition of all discipline, is entirely absurd.

III. Saint-Simonism and Inheritance

The school of Saint-Simon exerted a remarkable influence upon an entire generation of French thinkers, and even upon those of other countries, in the early part of the nineteenth century. This school insisted strongly on the claims of merit. It is not opposed to social inequality, but proposes to replace the equality due to wealth by that due to individual merit. It would turn all branches of human activity into public offices. People should be appointed to these positions and remunerated by the Government. The abolition of inheritance is

the keystone of this system. There are some points which should be brought out with regard to it :—

(1) Admitting for a moment that we might succeed in abolishing the inheritance of wealth, inheritance would still exist with regard to many other advantages, such as health, talent, and social rank.

(2) By depriving men of the right to dispose of the results of their labour, we should lose one of the most powerful incentives to production. There are many persons who work and save for others, not only for themselves. If you oblige them to think only of themselves, they will work less and spend more. A vast amount of wealth would thus be transferred from productive uses to unproductive consumption.

(3) If the head of the family is not permitted to designate his successor, who is to be entrusted with this important duty? Shall the Government appoint each individual to a particular occupation? Such a Government would have to be infallible to justify the exercise of so great a power. Even if appointments took place by popular vote or by competitive examinations, little would be gained. It seems foolish to regard the abolition of inheritance as the proper means of realizing the distributive formula of the school.

From the standpoint of ideal justice we may reasonably ask why intellectual or physical superiority ought to be a claim to greater wealth. Is not exceptional intelligence or physical superiority in itself a sufficient advantage?

IV. Collectivism

Collectivism is a moderate form of communism. It involves the common ownership of all instruments

of production ; products are still left under the régime of private property, although collectivists desire a more equitable distribution of them. Karl Marx has developed an elaborate doctrine of collectivism, which is often called Marxism, in honour of the illustrious theorist. All collectivists, however, are not disciples of Karl Marx. The Fabian Society in England and the so-called independent collectivists in France do not belong to the school of Marx.

Collectivism, at present, does not even advocate the common ownership of all the instruments of production, but only of those that are exploited collectively—*i.e.*, by means of the employment of wage-workers. It asserts, however, that a time must come when all the instruments of production will be transferred to collective ownership.

Expropriation, with or without indemnification, is the only means of accomplishing this transfer of private property to collective ownership. Collectivists declare that when expropriation has taken place the instruments of production will be utilized by the nation or the commune. The proceeds will be paid into the national treasury, which, after deducting the part necessary to meet the general expenses of society, will give back the surplus to the labourers. Collectivism proposes to reward each person according to the effort he has made, measured by the number of hours he has worked. Those who are unable to work receive a certain minimum allowance. Under this system no one will be able to profit except by his own labour. Thus it is supposed economic inequalities would be greatly reduced. It would do away with the idle classes and social parasitism, since no one could become the exclusive owner of land or capital. Collectivism,

however, does not do away with inheritance. But inheritability, being limited to objects of consumption, has but little importance. The proceeds of productive activity would be increased by the share which was previously appropriated by idlers and parasites. The labour required of each member of society would be greatly decreased. According to the calculation of an English socialist, one hour and twenty minutes per day would be enough.

It is held, moreover, that collectivism would do away with pauperism. If society became the owner of the instruments of production, it would find employment for all who were able to work ; and for those who were unable to work it would provide the means of subsistence.

Collectivists maintain, finally, that by recognizing the right to dispose freely of one's possessions, individual liberty would be kept perfectly intact.

In answer to these assertions, the following points may be raised :—

(1) The so-called law of social evolution upon which collectivism is founded—viz., the gradual transformation of individual production into collective production—is only a sweeping generalization.

(2) The right of private property, which collectivists assert they are simply narrowing, would be a mere illusion. If it possessed all the attributes which constitute the right, it would again give rise to the inequality of wealth. Hence, collectivists expressly stipulate that the so-called owner of property would in no case be permitted to sell or lend his share of the productive proceeds, or to use it as a means of employing the labour of others. He would be forbidden, in other words, to use it for any other than unproductive purposes. This state

of affairs would not be very reassuring from the standpoint of production.

(3) The plan to substitute directors, appointed by society or elected by labour unions, for all the captains of industry is calculated to cause grave anxiety in the minds of those who have any knowledge of practical industrial conditions and of the meagre economic training of the labouring classes.

But the social class whose disappearance may well cause most anxiety is that of the capitalists who save. Under the collectivist régime the great motive of individual saving would be destroyed. Public saving is suggested as a substitute. But a government which knows how to save, which is willing to save, and which is able to save, has never yet existed. We have no reason to believe that the collectivist government will be entirely unlike all preceding governments.

(4) The proposed distributive formula gives rise to an important ethical problem. Shall labour itself or the product of labour be the ultimate standard of distributive justice ?

Again, the practical operation of the formula would put a premium on laziness. Experience shows that a man who devotes most time to a given task is generally not the good but the poor workman.

Marx answers the objection by taking into consideration socially necessary hours of labour. He measures value by the period of labour required to produce any exchange value under present normal social conditions of production, and with the average degree of dexterity and intensity of labour.

This calculation is not an easy matter. Besides, when we speak of the labour of production, we should consider individual labour, not social labour. Justice has nothing to do with social averages,

V. Co-operation

The term *Co-operation* is now employed in a specific sense by those who regard it as a complete scheme of social reconstruction. The scheme is not socialistic, because it would retain private property, together with its principal attributes. Yet it seeks to realize several of the most important desiderata of socialism.

In the beginning of the nineteenth century, Robert Owen (in England) and Fourier (in France) invented ingenious schemes of voluntary association which proved unsuccessful. But the necessities of hard, practical life, more potent than theories of reform, have given rise simultaneously in several countries to widely different varieties of association. These associations have already begun to make important changes in prevailing economic conditions. We shall point out some of the important features which characterize all kinds of co-operation :—

(1) All co-operative organizations aim at the economic emancipation of certain classes of society.

(2) They all aim at the substitution of solidarity for competition.

(3) They all aim, not to abolish private property but to make it more general by facilitating the acquisition of private capital, and to create collective ownership of stores, banks, workshops, &c.

(4) They all aim, not to suppress capital but to deprive it of its controlling influence in production, and to withhold that part of the product which capital appropriates in the form of profits and dividends.

(5) Lastly, all these associations possess great educational value.

Co-operation is the only social experiment of the nineteenth century that has been successful. Co-operative credit associations and consumers' associations have developed most remarkably. Co-operative societies of production also have in some instances achieved glorious success, but these instances have thus far been few in number.

PART II. THE VARIOUS KINDS OF INCOME

WE shall now make a more detailed examination of the share which each of us receives as Income and discover the origin and causes of each kind of income.

To-day the principal agent of production, called the *entrepreneur*, usually furnishes only a small share of the elements indispensable to production ; he is obliged to borrow from others part or all of these elements--labour, land, and capital. He must therefore pay his collaborators for their assistance. To the labourer he must give wages, to the capitalists interest, and to the landlord rent ; the remainder he will keep to himself. This constitutes his income, and is called *profits*.

As said above, profit is that part of the value of the product which is left after the shares of the other participants have been withdrawn. Hence it is most convenient to begin with the study of the other three kinds of income.

Each of the three factors of production has its distinct share in the product. These various kinds of income seemed perfectly natural to the classical economists.

If we remember that labour, or rather man, is the true agent of production, and land and capital only instruments in his control, the serene confidence of classical economists in the reasonableness and justice of this symmetrical division is shaken.

CHAPTER I—WAGES

I. Definition of Wages

WAGES, as generally defined by economists, mean the income received by a person in exchange for his labour. The definition is not correct. It should be the province of science to discriminate between the various kinds of labour and the incomes arising therefrom. The word *wages* should be applied only to the remuneration for labour performed under certain clearly defined conditions. Wages should be defined as the price of labour hired and employed by an entrepreneur.

II. History of the Wage System

Even under the slave system of antiquity, there were poor freemen who hired their labour to the rich in exchange for money or for goods. But this kind of labour was entirely exceptional. Nor could there be a large class of genuine wage-workers under the guild system. The journeymen were doubtless paid by the master of the shop, but their relation to him was not that of the wage-worker to the employer. All of them hoped some day to become masters.

Toward the end of the Middle Ages new roads and routes were opened, and gave rise to national and even international markets. The mediæval masters were unable to produce on a sufficiently

large scale for these markets. Thus the modern employer of labour was evolved. The journeymen found it impossible to become masters and formed guilds of their own. From that time onward capitalists and labourers are separated.

Still another step was required for the evolution of a class of wage-workers such as exists to-day. Ultimately most European governments did away altogether with guild regulations and decreed the entire liberty of labour.

This last step made the workers free. Human labour became a commodity the value of which is fixed by the same laws as govern the value of any other merchandise. The modern wage system was thus fully evolved.

This economic régime has given a remarkable impetus to production. But the industrial liberty was at first much more profitable to the employers than to the employees. The latter were unorganized and were victims of laws which forbade them to unite. The guild system was a hindrance to the workman, but it was a protection also.

Many improvements have now been effected in the condition of employed labour for these reasons :—

(1) Because employees have learned to unite, and because the laws which prevented them from exercising this right have been abolished.

(2) Because in many countries so-called Labour Laws or Factory Laws have been passed in the interest of the working classes.

III. The Laws of Wages

Laws of Wages should formulate the general principles which determine the rate of payment for hired labour, and should indicate the causes of its

rise and fall. Before taking up the problem of wages, two distinctions require to be drawn very clearly, viz., that between the real and nominal wages, and that between the real and nominal cost of labour.

We often speak of wages as the labourer's share of the product. This, however, is not entirely accurate. Wages are almost always paid in money. They represent a certain share of the value of the product. But they are advanced by capitalists in anticipation of future return.

Payment in commodities—supplied usually by stores kept by the employers—is called the *truck system*. It has often been made a device for robbing the labourers.

The worker prefers to have his remuneration in money because of its advantages. The payment of money, however, must not blind us to the fact that what the labourer really works for is not money, but the things he wants. These are his real wages. Provided he gets more of them, it does not matter whether he gets more or less money. Walker defines real wages as “the remuneration of the labourer reckoned in the necessities, comforts, and luxuries of life.” He points out that wages may apparently be the same and yet differ widely by reason of the following circumstances :—

(a) Variations in the purchasing power of money.

(b) The form of the payment, as when the board of the labourer, the rent of the cottage, &c., are added to the money wages of the labourer.

(c) The great opportunities for extra earnings in some branches of industry.

(d) The greater regularity of employment in certain avocations than others.

(e) The longer duration of the capacity to labour in some avocations and some countries than in others.

From the standpoint of the labourer, therefore, real wages, not nominal or money wages, are of importance. From the standpoint of the employer wages may be high and yet labour may be cheap. When we speak of cheap labour, we refer usually to labour that is poorly paid. But this is not quite correct. The cost of labour is high or low as the employer gets an ample or a scanty return for the wages he pays the labourer, whether these be great or small.

Differences in the productivity of labourers in the same trade and locality are often so great, that wages are not paid according to the time of work but according to the quantity of work that is done. Such remuneration is called *piece* wages, as distinguished from *time* wages.

In view of the fact that wages vary from trade to trade, from time to time, from place to place, we may ask whether there are, in fact, any natural laws which regulate the rate of wages.

It is not the province of a scientific law to explain each particular case in all its details, but to formulate those general and permanent tendencies which are everywhere present.

As labour is simply a commodity, it is evident that its price must be determined by the same laws as those which govern the price of any merchandise. But the formula of demand and supply, applied to problems of distribution, lacks scientific precision. Many economists have abandoned it and endeavoured to discover a more accurate and satisfactory formula.

Three important wage theories have been sug-

gested, each of which has attained considerable celebrity, and each of which has its advocates at the present time.

(1) *The wages fund theory.* For a long time this was the classical English theory of wages. It is merely a more precise statement of the theory of demand and supply. The supply consists of the labourers who are in quest of work. The demand consists of the capital which seeks investment. The ratio between this capital and the number of labourers determines the rate of wages. Take the circulating capital of a country, which English economists call the *wages fund*. Then take the number of labourers. Divide the former quantity by the latter, and the quotient is the average rate of wages.

According to this theory a rise in wages is possible in only two cases :—

(a) If the wages fund is increased ; and the only way in which this can be done is by saving.

(b) If the labouring population is diminished. This can be done only by the labourers applying the principles expounded by Malthus ; either by abstaining from marriage or by having few children.

Certainly this theory is not encouraging for the future of the working classes. It is feared that the divisor will increase far more rapidly than the dividend. Population increases spontaneously, but not capital.

The wages fund theory is now generally discredited. The thought on which it is founded, viz., that a certain definite amount of capital is necessary for employing labourers, is of interest only with regard to production, not with regard to distribution. To know whether an entrepreneur

has the means to set labourers to work, is one thing ; to know what share of the proceeds of the enterprise he will be able to yield to his employees, is quite another thing. The first of these matters depends upon what he possesses ; the second depends upon what he produces.

The apparent exactitude of this theory, moreover, is illusory. When we examine it more closely it amounts to saying that the average rate of wages may be ascertained by dividing the total amount paid out as wages by the number of wage-earners. This is simple tautology.

We must inquire finally whence comes this circulating capital, this wages fund. Obviously from labour itself. Wages are taken immediately from capital, but the quantity withdrawn from it is added to it by the products resulting from industry.

The most destructive criticism of the wages fund theory is that presented by Thornton, whose celebrated book "On Labour" led J. S. Mill, who had most skilfully elaborated the theory, to abandon it. Thornton maintains that labourers by combining may raise the rate of wages ; and if this be true, there can be no fixed wages fund. If there be a national wages fund, it can only be an aggregate of smaller funds. But is there any specific portion of any individual's capital which the owner must necessarily expend upon labour ?

(2) *The iron law of wages.* Lassalle declares that the price of labour, like the price of all other merchandise, is determined by the law of supply and demand. But the average ratio of supply and demand is determined by the necessary cost of production. Thus it is the cost of production of labour which determines wages.

Now the cost of production of labour includes :

(a) the amount necessary to support the workman ; (b) the amount necessary to replace him by another workman when he becomes unfit for work.

Thus wages are necessarily determined by the minimum that is absolutely necessary for the support of the labourer and his family. For thirty years this theory has been repeated again and again by socialistic agitators. It was advanced first by classical economists. Turgot was the first to declare that in every kind of labour the workman's wages must fall to a level determined solely by the necessities of existence. J. B. Say and Ricardo used almost the same words.

If the theory means that the workman's wages can never rise above what he absolutely requires to live on, it is much too pessimistic and manifestly contrary to facts. Why is the rate of wages not the same in all trades? Must a skilled mechanic consume more food-stuffs than a stone-breaker? Why are wages higher in the United States than in England? Is there any physiological reason why an American should eat more than an Englishman?

But this law is sometimes interpreted in a broader sense. It is sometimes taken to mean that the wages of labour are governed by the standard of living of the working class to which a man belongs. If we are agreed that this standard of living is in reality elastic, we should speak not of the iron law, but of the golden law, of wages.

According to this theory, the wages of the workman would not determine his manner of living, but, on the contrary, his manner of living would determine his wages. If so, who could be more fortunate than they? To increase the wages they have simply to go on increasing their expenses.

In reply to this theory it is objected that labourers would lower their standard of living rather than starve. The famine-stricken millions of human beings struggling for existence in times of destructive famines in India supply overwhelming proof of this.

The theory mistakes cause for effect. Wages are not high because the standard of living is high, but vice versa. To get better wages a man must increase his productivity- that is to say, his usefulness to those who employ him. It is no use trying to raise wages by increasing the standard of living.

(3) *The theory of the productivity of labour.* According to this theory the value of labour depends on its productivity. The most striking form of the theory is that given by Walker. This theory maintains that the workman receives as wages all that remains of the total product when interest, rent, and profits have been deducted. These three shares are strictly determined in their respective amounts, whereas the worker's share possesses the advantage of not being fixed. The wage-worker may be compared to a residual claimant or legatee who takes what is left when the other heirs have received their stated shares of an estate.

This theory, if sound, would be quite encouraging. Everything that increases the worker's productivity will inevitably increase his wages.

The wages fund theory was too pessimistic ; this doctrine is too optimistic. Yet both theories make it appear impossible for labour organizations to improve the condition of the working classes. For if the labourer is a residual claimant, he is powerless to increase or decrease his share in distribution, except by an increase in his productivity.

Walker makes an important provision that an increase in the product goes to the labourer by purely natural laws provided only competition be full and free. But it must be said that these conditions are rarely fulfilled.

How little is this theory justified by facts ! No doubt the productivity of labour influences the rate of wages by increasing the general wealth of a country. It is also true that whenever a particular kind of labour is more productive than others, more wages are usually paid. But this theory leaves in the background one of the most essential factors of the problem, viz., the abundance or scarcity of labour.

An attempt has been made to elaborate the productivity theory more scientifically by the economists who accept the doctrine of Final Utility. The German economist von Thuenen was not only the first to develop this doctrine as a scientific explanation of value, but he appears also to have been the first writer to apply it to the solution of the problems of rent, wages, and interest.

According to this school of thinkers the rate of wages is determined by the *marginal productivity of labour*. There is in every business enterprise a point beyond which it will not pay the entrepreneur to hire more labourers. Now the net profits of any business are greater when the number of labourers has reached the point where the last labourer will produce more additional value than he costs his employer. If the labour of the last man is the same as that of the others, it is evident that all labourers will receive the same wages because different wages cannot be paid for like labour. In other words, the wages received by the marginal labourer must determine the wages paid to all the

other labourers of the same kind and the same ability.

This theory is practically an extension of the law of diminishing returns, which occupies so important a place in the theory of land rent. Professor J. B. Clark, an advocate of this theory, speaks constantly of "distribution by a law of rent."

In conclusion, there is not one determinant of wages, but several causes which operate with varying degrees of influence at different times and under different circumstances. All the forces that influence the value of merchandise also affect the value of manual labour. There are, moreover, other determinant influences peculiar to wages—such as public opinion, strikes, and the growing consciousness among workers of their rights and their social importance.

IV. The Increase of Wages

A gradual increase of wages during the past century seems beyond question. Innumerable statistics from all countries show that wages have been more than doubled. Yet we must not overlook a number of circumstances which make the increase less beneficial than we should at first suppose it to be.

(1) In the first place, this increase of wages is partly *nominal* and due in a measure to the depreciation of money. After comparing the wage statistics and the price statistics, it is not far from truth to assume that the cost of living for the average working-man's family has increased about one-third since the beginning of the nineteenth century ; and as wages have increased considerably

more than this, we may infer that *real wages* have increased.

(2) The increase in wages, though real, *has not been proportionate to the growth of general prosperity*. In other words, the wages of labour have increased more slowly than the income of the other classes of society.

From the standpoint of social justice, we must admit that the labouring class is entitled to an increase of income at least proportionate to that of the other social classes.

(3) It should be noted, finally, that the average wages given by statistics are assumed to be paid regularly throughout the year. But in many trades there are frequent periods of obligatory inactivity known as "dead seasons." Again, there are large numbers of workmen who cannot find employment of the kind for which they are fitted, and who are therefore obliged to turn to lower occupations with poorer pay. A large number of labourers, moreover, are employed only part of the week, or part of the day. Unemployment is becoming a chronic ailment of our present economic system.

Is this rise of wages due to natural or artificial causes? The uncompromising members of the classical school do not believe in the existence of artificial means. They declare that all we can do is to make labour more mobile, quickly transferable from one place to another, or from one occupation to another. This alone is sufficient to cause the price of labour to rise gradually as a result of the general increase of wealth.

There is no doubt that the increase of wages during the nineteenth century is due largely to natural causes. But there are other causes also. We must not forget that fixing the price of manual

work always presupposes a certain amount of higgling. The greater advantage will always accrue to the stronger party. The intervention of law, the influence of labour organizations, and sometimes strikes, are effective means of accomplishing a new and more favourable adjustment of wages.

V. The Hours of Labour

Shortening the work-day is one of the reforms to which great importance is now attached. Socialists regard it as a means of emancipating the labourer, and of preparing him for the social and political struggle for class supremacy. Labourers regard this reform as meaning less work with the same pay. But the greatest significance of this movement lies in the fact that it gives increased opportunity for the intellectual, moral and physical improvement of the labouring-classes, by enabling the workers to cease being mere productive machines and to become men.

It is often said that business competition among modern nations is so intense that it would be difficult for one country to shorten the work-day without placing itself in a position of competitive inferiority. No doubt international agreement on such matters is desirable ; but each nation should not make it a pretext for waiting until others take the first step. Experience has shown that countries both ethically and industrially advanced have not much reason to fear competition from countries having longer work-days.

For the solution of the problem we must take into consideration the age and sex of the individual worker.

(1) *Child labour*. All civilized countries, with

but a few shameful exceptions, forbid the employment of young children in factories and workshops. Usually the law provides that no child under ten years of age shall be employed, and that those from ten to fourteen must have a certain amount of schooling and a sufficient amount of time for rest and recreation. Certain dangerous occupations are sometimes entirely forbidden to children and minors, and night work is in most cases not allowed to persons of less than eighteen years of age.

It must not be supposed that these limitations on child labour were enacted without opposition. The campaign against child labour, begun in England in 1802, owes its ultimate success in 1844 to the heroic perseverance of the Earl of Shaftesbury.

The adversaries of laws against this state of affairs argued that it was the business of the parents to look after their children, not that of the State. There can be no doubt, however, that there was a most abominable traffic in the labour of children, conducted on a very large scale.

(2) *The labour of women.* In the case of women the problem is more difficult. With the introduction of machinery, it became possible to employ the labour of women, which is cheaper than that of men. So many occupations are thrown open to women that the fear has sometimes been expressed that women are crowding men out of employment.

Some persons have advocated the entire exclusion of women from factories and workshops. They urge in favour of this measure that the industrial employment of women destroys the family and the home, and exposes women and girls to morally and physically pernicious influences; in the case of pregnant women the health of the mother and

child is jeopardised, and the risk of abortion is greatly increased.

On the other hand, it should be advanced that at a time when so much is being said in favour of the equality of sexes, it would be strangely illogical to prevent women from earning a living by their own labour. Unmarried women find it hard enough now to earn an honest living ; their condition would certainly not be improved by closing the factory doors to them. The outcome of this discussion, therefore, is a sort of compromise. Women are usually not forbidden to work in factories ; but in many countries they are not allowed to engage in certain dangerous kinds of labour. In some countries night work and work during a period of several weeks after child-bearing, are likewise prohibited.

(3) *Adult male labour.* It is, of course, entirely out of the question to forbid the labour of adult males in factories. The question is whether it should in any way be limited. The liberal school argues that adult individuals ought to be entirely free to regulate the use of their time and of their labour. To this assertion we may reply that under the present system this liberty is impossible. The labourer must start work when the factory whistle blows ; he must stop work when the factory stops.

We are naturally disposed to believe that a decrease in the hours of labour would necessarily mean a diminution of the product and a fall in wages. Actual experience proves the contrary. Limitation of the hours of labour by law, however, is still the exception rather than the rule. Labourers themselves naturally advocate a shorter work-day than is now customary.

VI. Trades Unions

The workman who deals individually with the employer is at a considerable disadvantage for the following reasons :—

(1) The capitalist can wait, whereas the labourer cannot.

(2) The entrepreneur can get along without the workman, whereas the workman cannot readily dispense with the employer.

It is an easy matter to find another labourer, but it is not so easy to find a new employer.

(3) The entrepreneur has better opportunities for grasping the whole economic situation and taking advantage of it.

For these reasons the labour contract has generally been a free contract in name only. But when labourers form an organization, employer and employee are more likely to be on an equal footing for the following reasons :—

(1) Labour organizations enable the workman to refuse to work when the terms of employment are unsatisfactory. They support him during the period of unemployment.

(2) Labour organizations oblige the employer to deal with a whole group of labourers or their representatives, because he cannot deal with individual labourers.

(3) Labour organizations provide bureaux of information for labourers.

To the economists who maintain that trades unions cannot arbitrarily fix the rate of wages, we must reply that this is not their purpose. All they seek to do is to obtain the wages justified by the general state of the market.

Labourers first acquired the right of coalition,

i.e., the right to act as a unit in demanding certain terms of employment, and in case of refusal to abandon work and to strike. But the right to act jointly is not enough. In order to be effective, the claims of labourers must be backed by permanent associations. In English-speaking countries they are commonly called Trades Unions.

England is the classic country of trades unions. Many of the English trades unions are wealthy organizations, grouped into powerful federations directed by prudent and distinguished men. They have devoted themselves to the practical task of increasing wages or reducing the hours of labour without asking for Government intervention, and they have been moderate in the use of strikes.

The unionist movement has extended to the ranks of unskilled labourers, who have formed numerous organizations, showing a pronounced tendency towards socialism. This tendency is sometimes called "the new unionism."

In respect to the strength of labour organizations the United States rival Great Britain. The Federation of Labour is the greatest labour organization in America. The objects of trades unions in the United States are essentially the same as in England. They pay benefits, as a rule, in case of death, sickness, or permanent disability of a member.

Trades unions have undoubtedly increased the power of the working classes. They have contributed to the education of labourers and promoted culture and social intercourse among their members, and have secured better conditions in the labour contract in several ways.

I. STRIKES

A Strike is a concerted refusal to work. Strikes are often regarded as the sole purpose and the essential function of trades unions. But this is a mistake—in fact, the best organizations and most powerful unions are those that declare the fewest strikes. In most civilized countries the right to strike is not controverted, but the effectiveness and wisdom of strikes is still a matter of discussion.

Strikes, being appeals to force, possess all the disadvantages of war. They entail an enormous waste of productive energy ; they cause great sufferings, and leave in the heart of the vanquished party a feeling of resentment. But it cannot be denied that they have helped to raise wages and reduce the hours of labour. The efficacy of strikes must not be judged from the number that are recorded as successful. A single successful strike may result in an increase of wages in a great many industries. It is, moreover, not so much strikes themselves which raise wages as the constant fear of strikes.

Those who deny the efficacy of strikes point out that wages have increased equally rapidly in those occupations in which strikes never occur. But why is this true? Because these classes of labourers have profited indirectly by the increase of wages in the organized industries. Wages have increased on the farms simply because labourers have migrated from the country to cities in quest of better wages. Wages of domestic servants naturally tend to increase whenever the wages of industrial employees increase. Trades unions are becoming the regulators of the labour market.

2. ARBITRATION AND CONCILIATION

Conflicts between labour and capital tend to be adjusted by peaceful agreements ; but in order to accomplish the best results labour organizations must be sufficiently strong and enlightened. In some of the great industries of England, Boards of Conciliation and Arbitration perform their work successfully. In the United States the principle of conciliation and arbitration has steadily gained ground.

The formation of a committee representing both labour and capital, for the purpose of considering fairly the questions at issue, is an eminently rational method of settling disputes. This method is known as *conciliation*.

Arbitration is an appeal to the decision of an impartial third party. It has often proved successful where boards of conciliation have failed. Sometimes the two parties to a dispute voluntarily agree, in advance, to abide by the decision of the board of arbitrators.

New Zealand has introduced *compulsory arbitration*. In that country the board of arbitration is really a court of law ; it may even try to settle labour conflicts upon its own initiative. This system appears to work well and has preserved industrial peace. But we must remember that New Zealand is a small country, in which trades unions have long been powerfully organized, and in which they include the whole labouring population. Wherever labour organizations are still in an embryonic state, there is practically no way to make arbitration compulsory.

Another device for securing industrial peace is the establishment of *sliding scales*. As a result of an agreement between employers and employees, the

rate of wages is determined arithmetically according to the selling-price of the product. When prices rise wages rise, and vice versa.

VII. • Working-men's Insurance

Every labourer is exposed to five possible misfortunes—illness, old age, death, accidents, and loss of employment.

The labouring classes have succeeded in providing against only one of these risks—illness—by means of mutual benefit societies. These societies are supported by small dues, and usually meet the doctors' and druggists' bills of sick members. As regards the four other risks, little or nothing has been done by the labourers themselves. The poorer classes cannot afford to insure themselves against death and accidents.

As regards insurance against loss of employment, the English trades unions have accomplished excellent results, because of their strong organizations and because of the high dues which their members are obliged to pay.

Some employers have voluntarily founded insurance funds to provide for the financial relief of disabled members. Sometimes these funds are furnished entirely by the employers, sometimes they are provided by both employers and employees. Arrangements of this sort, however, are the exception rather than the rule.

In Germany the expense of providing against illness, accidents, old age and incapacity to work, is borne partly by the employers, partly by the employees, and partly by the Government. There are, however, two risks against which the German system makes no provision—unemployment and death.

Labourers' insurance is obligatory under the German system. In most countries it is entirely optional. The plan of optional insurance is not only in better harmony with the principles of Liberalism, but less vexatious and less burdensome. On the other hand, it is to be feared that optional insurance will cover only a small part of the population.

The German system provides insurance against three risks only. It was originally the intention of the Government to provide also for labourers' insurance against death.

With regard to insurance against loss of employment, the difficulties are insurmountable. Nothing is harder than to find out whether the labourer who claims to be unable to find employment is truthful and sincere. Again, this misfortune involves large groups of labourers simultaneously.

VIII. The Future of the Wage System

The wage system has its advantages and its defects. The following are the two principal advantages attributed to it :—

(a) To the entrepreneur it secures the entire control of the business.

(b) To the labourer it guarantees a certain fixed and immediate income.

These advantages are so pronounced that the wage workers and the entrepreneurs prefer this system to all others.

In our opinion, however, the following disadvantages of the wage system far outweigh its advantages :—

(1) This method of remuneration treats labour—that is to say, labourers—as a commodity, and

regards it as subject to all the laws that determine the value of commodities. Chateaubriand declared that the wage system is a survival of the slave system.

(2) The labourer gives up all claim to the product of his labour in consideration of a fixed sum. He has no incentive to do his best. The only motives that can lead him to work well are duty and fear. Of these two motives the first is felt only by exceptional minds, and the second has never succeeded in getting men to do more than the least possible amount of work. To overcome this disadvantage, there is now a tendency to adopt the system of piece-wages. Labourers are generally opposed to it. They have often advocated the system under which a group of employees agree to perform a certain task or job at a price fixed upon with their employer. The employees constitute a sort of small co-operative association in the midst of the factory.

(3) This system, finally, is sure to create strife between master and workman.

Each great school of economists has its own particular plan for the reform or abolition of the wage system.

The liberal school regards wages as the most perfect conceivable system of remuneration. The only improvement which it advocates is to make the labour contract still more free. This may be accomplished either through the exercise of the right of labourers to organize or by means of such institutions as Labour Exchanges, which make traffic in labour more nearly like traffic in merchandise.

The collectivists demand the abolition of the wage system. But we believe that collectivism would only perpetuate it and make it universal. Collectivism

proposes to make the nation the only entrepreneur. It would not suppress the class of wage-workers, but it would do away with the class of employers.

The catholic school accepts the wage system as a normal and permanent condition, but it protests against the treatment of labour as a commodity. It maintains that the labourer has a right to fair wages. Catholic reformers usually accept the idea that the "fair wage" must be fixed by law. From a purely theoretical point of view, wages established by law must be regarded as unjust, because it implies that wages at a fixed figure shall be regarded as fair.

The co-operative school regards the wage system as a relatively inferior method of remuneration. Co-operators expect that some day the labourers will be united in co-operative societies owning the instruments of production, and that they will cease to be employees and will become their own masters. Meanwhile, this school endeavours to graft upon the wage system the arrangement known as "profit-sharing."

CHAPTER II—INTEREST

I. The Ownership of Capital

SHOULD private property in capital be regarded as legitimate? This question has given rise to heated controversies. The classical economists have answered the question decidedly in the affirmative. They maintain that the right of private property in capital is based on a twofold claim: it is not only due to the labour of production, but also to that of saving.

The legitimacy of property in capital has nevertheless been vigorously attacked by socialists. Marx regards private property in capital as a result of past spoliation and a means of continuing this spoliation in future.

Collectivists divide capital into two classes—small capital and large capital. The former, being the result of the owner's labour, they regard as legitimate private property; in the latter, which involves the appropriation of the product of others' labour, they regard private property as illegitimate. Now, all large capital must have been small at one time. We are thus led to the conclusion that private property in capital is legitimate at the outset, continues to be so up to a certain point, and then becomes an abuse.

The assertion that capital, by its very nature, can be increased only by plundering the labourer

is objectionable. Moreover, the ownership of capital is dictated by social utility. The development of production absolutely requires a supply of accumulated wealth.

The problem of private property in capital once settled, there are still two others to be solved :—

(1) Has the owner of capital the right to lend it to others on interest?

(2) Has he the right to use it to set others to work, making a profit thereby?

II. The Legitimacy of Interest

Of all kinds of income the legitimacy of none has been more violently contested than that of Interest. The following are the principal points that have been raised during the controversy :—

(1) It was asserted by Aristotle, among others, that money is unproductive.

To this economists reply that money only represents capital which is productive.

(2) It was asserted that in lending money the lender undergoes no genuine privation, and therefore has no right to an indemnity.

In answer to this, the economists endeavour to prove that the capitalist must deprive himself in order to create capital.

(3) It was asserted that the perpetuity of interest is unnatural and unjust. At the rate of 5 per cent. (simple interest) the lender will collect the original sum twice over in twenty years.

To this it is answered that the regular payment of interest is by no means the same thing as the gradual restitution of the loan, any more than the annual rent of a farm is part of the purchase price of the land.

(4) It was asserted that the borrower is obliged to pay back more than he has received.

This the economists deny. There is a difference in the value of present goods and future goods.

In antiquity and the Middle Ages the discussion with regard to interest was largely ethical or religious. With the classical economists and their successors the problem became economic. Various theories have been started to account for interest. Boehm-Bawerk makes the following classification :—

(1) *The productivity theories.* This name is applied to the theories based on the fact that a workman provided with capital can produce more products than without capital. This additional product produced by capital constitutes interest. J. B. Say seems to have been the first author to speak of the productive power and the productive services of capital.

(2) *The use theory.* The fullest statement of this theory is found in the Austrian economist Menger. The theory asserts, in brief, that in capitalistic production there is a sacrifice, not only of the material substance of capital but also a sacrifice of the use of the capital during the period of production.

(3) *The abstinence theory,* first clearly stated by Senior. If men postpone the present enjoyment of their wealth and devote the resources so spared to production, it is manifest that the resulting increase in product is very intimately connected with the saving which made productive methods possible.

(4) *The labour theories.* This head includes a number of theories which agree in considering interest as the remuneration for labour performed by the capitalist.

(5) *The exploitation theory.* This celebrated

theory, founded by Marx, regards rent, interest, and profits as due to the exploitation of working-men. As applied to interest, it may be stated as follows :—

The value of a commodity is measured by the quantity of labour required to produce it. Capital is not an original factor of production, but may be resolved into the labour that produced it. The whole product, therefore, belongs in equity to the labourer.

(6) The sixth group of authors treats the problem of interest as a problem of value, and draws attention to the influence of time in the estimation of values. Present goods are, as a rule, worth more than future goods of like kind. Whoever exchanges present for future goods demands some premium ; this premium is interest.

Some of these theories are endeavours to explain interest. Others are attempts to justify the capitalist's income. We may safely accept the principle that so long as there is capital there will be interest. The question is, Shall we admit the legitimacy of private property in capital? If we do, the legitimacy of interest follows as a logical consequence. What is the need of inquiring whether the wealth is employed productively or whether the owner undergoes privation? As the legitimacy of interest seems so evident to-day, why has it so long been denied? Because of historical circumstances which we shall now consider.

III. History of Loans at Interest

Throughout antiquity loans were made at interest. But Moses, Aristotle, Cato, and the Church Fathers have stigmatized it: Although this attitude subsequently came to be regarded with profound con-

tempt, it can very easily be explained by the conditions which prevailed at the time. Borrowing in those days was resorted to chiefly by the poor for procuring means to buy bread. When the time for payment came, the debtors could pay neither interest nor capital; they were therefore forced to become the slaves of their creditors. This is sufficient to explain the old and stubborn prejudice against interest. The economists, however, allowed interest on loans for productive purposes.

The Reformation brought about a reaction. But the economic doctrine in favour of loans at interest was fully established by Turgot and Bentham.

To-day the parts have been inverted. The rich and powerful borrow from the public, and make up their funds out of the savings of the masses. The lender is a worthier object of compassion than the borrower. The entrepreneur now pays interest, and this interest is part of the cost of production. It would therefore be absurd to dispense with the payment of interest.

IV. The Laws of Interest

Many of the classical economists were unable to get a very accurate notion of interest. They treated interest and profits under the general name of Profits. In popular speech to-day profits are sometimes made to include interest on capital. Economists have deemed it advisable to draw a distinction between these two incomes. They have also endeavoured to remove from the concept of interest several elements which in popular parlance are included in it. Pure interest, *i.e.*, interest in the strictest sense of the term, may be defined as the price paid for the use of capital or, from the dis-

tributive point of view, as the share of the capitalist in the product of industry.

In the real world of business we rarely encounter pure interest, but nearly always find it combined with other kinds of compensation, of which the following two are most frequently present :—

(a) The cost of renewing fixed capital, the constant use of which involves wear and tear. (This does not apply to capital in the form of money.)

(b) The payment for the risk attending the investment of capital.

Pure interest, therefore, is that which would be paid for the loan of money in large sums and for long periods under conditions of absolute security. If capital were lent in the shape of commodities, a different price would have to be paid for the loan of each commodity, according to its quality, durability, and productivity. But capital is usually lent by means of money or credit instruments. This fact accounts for the frequency of the statement that interest is paid for the use of money. What the borrower really wants, however, is not money but the goods that money will buy.

An important consequence of this fact is that the rate of interest does not depend on the amount of gold and silver that the country possesses, but on the amount of its riches or stock. Yet it is a popular idea that the rate of interest depends on the amount of money in the country. This idea is correct in the case of short-time loans. Interest, as well as capital itself, exists in the form of money. A fluctuation in the value of money operates equally and simultaneously on both. It is therefore clear that the rate of interest cannot be affected by these fluctuations.

As all kinds of capital are lent and borrowed in

the form of money, they are on the same footing. It follows, then, that there is, at a given time, but one and the same rate of interest in the money-market of a whole nation or even of the whole world.

The question now arises, What are the laws which determine this general rate of interest? There are many factors which may be summed up in the old formula of supply and demand, or in the newer doctrine of final utility.

The supply of capital depends on the following factors :—

- (a) On the nation's capacity for saving.
- (b) On the security afforded to investors.
- (c) On the existence of a large class of persons unable or unwilling to utilize their own capital in active business.

The demand for capital is determined by its productivity. As long as there is any advantage in the employment of capital the demand for it will continue to increase. The point beyond which the use of additional capital would not be advantageous has never been reached in the industrial life of any nation.

Capital will, of course, first seek those investments in which the returns are the greatest ; whatever capital is not thus employed must turn to less and less productive uses. But there cannot be different rates of interest. Naturally the rate of interest is determined by the return from the least productive use of capital—in other words, from the last increment of capital that is employed productively.

Interest, like wages and rent, is agreed on in advance, and it is not influenced by the outcome of the enterprise. Modern credit has, however, devised an arrangement by which the lenders may

get a share of the profits, if there are any. If there are actual losses, they are met with the creditor's capital. Under this arrangement the credit instruments owned by the lender are called *shares of stock*, and the income derived therefrom *dividends*.

Y. Does the Rate of Interest tend to Fall?

From the standpoint of distribution it is desirable that the rate of interest shall fall. It would reduce the share of the capitalists and would increase the share that may go to the other participants in production. Also from the standpoint of production a fall in the rate of interest diminishes the cost of production and facilitates the completion of enterprises that are otherwise impossible.

But it is not sufficient to show the desirability of a fall in the rate of interest. We must ask whether it is likely to occur. Is it of a permanent nature? Political economists have answered these questions in the affirmative.

As a matter of fact the rate of interest has fallen during the past thirty or forty years from six or seven per cent. to three or four per cent. The theoretical argument is that in a progressive society capital is becoming more abundant and investments more secure. These seem valid grounds for believing that capital will become less productive; there would even appear to be no assignable limit to this decline. But no one of these arguments is conclusive. The very suddenness and extent of the decline in the rate of interest indicates that this is not one of those great historical changes which constitutes economic evolution, but a temporary oscillation. History confirms this supposition.

The prophecies regarding a decrease in the risks incurred by capitalists and the diminished productivity of capital are of doubtful validity.

In short, it seems most likely that the rate of interest will rise again after having reached a certain minimum level. The reaction, in fact, has already begun.

A steady decline in the rate of interest might be brought about, not through the operation of supposed natural laws, but through the rational and persevering effort of men combined into mutual credit associations. This would, indeed, be a most sensible form of collectivism.

CHAPTER III—THE RENT OF LAND

I. The Law of Rent

Is there a surplus income that is peculiar to land, separate and distinct from the return for labour and for the use of capital?

Some economists deny the existence of such a separate and distinct return. They maintain that a return from land is necessarily made up of wages, interest, and profit. But this theory is not generally accepted.

The Physiocrats, Adam Smith and J. B. Say, regarded the return from land as really due to natural productive qualities of the soil. If the landlord profits by these qualities, this is simply because property in land constitutes a genuine monopoly. This explanation of the revenue from land implies the idea that Nature can create value. It implies adherence to the doctrine that value is based on utility.

Such an explanation could not satisfy Ricardo. He was the principal author of the theory according to which value depends on labour and the cost of production. Therefore he could not, without demolishing his whole theory, admit that the value of land is created partly by Nature. Nor could he hold that the return from land represented nothing more than the labour of cultivation. In order to escape this dilemma Ricardo invented his celebrated theory of Land-Rent

Originally, said Ricardo, as men were obliged to cultivate only a small section of land, they chose the best plots. The cultivation of these plots did not yield a greater income than could have been obtained from any other employment of labour and capital. But the increase of population necessitates an increase of production ; and when all the land of the first quality has been appropriated, less fertile land must be put under cultivation. It is clear that the cost of production on this inferior land will be higher than that on the land of the first degree. But the products from both these kinds of land will realize the same price in the market, and this price will be determined by the cost of production on the inferior land, leaving thus a gain to the owners of the superior land. This gain is precisely what is called *rent* in Ricardo's theory.

As population continues to grow and to require an increased supply of the means of subsistence, men are obliged to cultivate lands of even poorer quality. This order of cultivation may go on indefinitely, always causing a rise in the price of food and an increase in rent.

In Ricardo's theory of rent we must take it for granted that there is always some land for which no rent is paid. This is the land, however, that plays a decisive part in the determination of rent. The income of all other lands is due to their relative fertility, *i.e.*, to the comparative barrenness of competing lands. The owner of a fertile plot of land enjoys a monopoly of a peculiar kind, which does not consist in being able to sell above the market price but in ability to produce below the market price. In other words, prices are not high because rent is paid, but rent is paid because prices

are high. Rent is not the *cause* but the *effect* of the prices.

Ricardo's theory is now somewhat out of favour. Yet we must accept the theory as true in its general features, except the historical order of cultivation, which is by no means an essential part of it.

Rent is of a peculiar nature that distinguishes it from profit, because it is wholly beyond the influence of competition, and because it is due to forces absolutely independent of the control of him who receives it. The landlord plays a purely passive part.

As used popularly, the term *rent* has a much wider significance. It is applied to whatever is annually paid to a landlord by his tenant.

II. The Unearned Increment of Land

We must bear in mind that land has three characteristics which no other wealth possesses in the same degree.

(1) It provides for the satisfaction of human wants, which are essential and permanent.

(2) It is limited in quantity.

(3) It lasts for ever.

In view of these facts we can understand why the value of land increases constantly. The growth of population is the principal cause of increasing rent. The English economists designate this surplus value of land by the significant name of *unearned increment*.

There are two factors capable of arresting the increase of rent or causing it actually to decrease. The first is the competition of new lands which may take place as the result of colonization or im-

provements in the means of transportation. The second is a great and sudden improvement in the manner of farming.

It should be noted that neither the one nor the other of these two possible causes of a decline in rent would affect building lots.

III. The Legitimacy of the Rent of Land

The circumstances which cause an increase of rent, do not speak in favour of the Legitimacy of Land-Rent. Yet if the legitimacy of private property be established, that of land-rent would necessarily follow.

But is property in land legitimate? Land possesses the unique characteristic of not being a product of labour. All goods are the product of labour except land. If we accept the theory that the basis of property is labour, we must conclude that all things may come under private ownership, except land.

The optimistic school asserts that land is just as much the product of labour as any other kind of wealth. Man has not created land; but labour never creates anything, it simply modifies the materials that Nature provides.

And even if the land were not a direct product of labour, it is (says the optimistic school) at least the product of capital. If we kept account of all the expenditure incurred by the successive owners of land, we should reach the conclusion that no land is now worth what it has cost.

Despite the element of truth which this argument contains, it does not seem to be conclusive. Although land is the instrument of labour, it is not the product of labour. It existed before any human

labour. Man by labour and expenditure confers additional utility on it. But the soil has its original value. This original value is most easily perceptible in the forest that has not yet been cleared, but which may be sold or rented at a high price. It is equally plain in the case of building lots in large cities. Even in the case of cultivated land, the natural value of the soil is evidenced by the unequal fertility of different farms which have been subject to equal labour and expenditure.

The argument that no land is worth what it has cost is mathematically false. It is not enough to add the value of the labour and capital expended on a given piece of land. We must consider all the receipts from the land. If we do this the balance will show that land has yielded a constantly increasing revenue.

It is difficult to defend private property in land from the standpoint of abstract justice. The best defence is that it is based upon public utility. Its origin is due to historical forces :—

(1) The growth of population compelled mankind to practise more "intensive" farming.

(2) To stimulate labour it was considered necessary to give the cultivator, not only a right to the products of the land but also to the land itself. Finally this right was made perpetual.

IV. The Evolution of Property in Land

We may distinguish six successive stages in the Evolution of Landed Property.

(1) Landed property can arise only with the beginnings of agriculture. There can be no such property among races leading a nomadic life. Even in the early phases of agricultural life landed pro-

erty is not yet instituted, because land is superabundant, and because the farmer leaves one field as soon as it is exhausted, and takes another.

(2) Gradually population becomes denser, and more closely attached to the soil. The first stage is succeeded by the second, viz., that of temporary possession together with periodical divisions.

(3) There comes a time when these periodical divisions fall into disuse. Skilful farmers who have improved the land do not willingly submit to the arrangement. Thus arises the institution of family proprietorship.

(4) Conquest creates a new disturbance. In Europe the victors assumed the legal ownership and overlordship, leaving the subjected people practically in possession of the soil. Thus arose feudalism.

(5) The growth of individualism and of equality resulted in the final establishment of free property in land.

(6) But one step more must be taken. It consists in making property in land perfectly mobile and transferable. This final step has been taken in Australia. It is probable that Europe also may see the introduction of this system.

It can be seen from the above review that property in land has gradually departed from its original collective form and become increasingly individualistic.

V. The Hire of Land

In the United States agriculture has been carried on chiefly by the proprietors themselves, in England by the farmers who hire the land owned by some rich man.

Rent closely resembles wages and interest. Bu

there is a great difference also. In the contract between the labourer and the entrepreneur the latter occupies a predominant situation, whereas in the contract between the landowner and the entrepreneur known as *tenant*, the former undoubtedly has the advantage. The price paid for the hire of a farm (Fr. *fermage*) is usually greater than the economic rent. There are improvements connected with the farm of which the landlord is the owner. In respect of these, he is the capitalist, and the return he receives is interest. The pressure of necessity may oblige the tenant to pay the landlord a part of the reward of his own labour. It may happen, on the other hand, when tenants are in great demand, that they will retain for themselves a part of the proceeds due to the natural advantages of the land. It may be said that generally rent, like wages and interest, is determined by the laws of supply and demand.

The system of tenantry and the income due to it must be regarded as incompatible with the best interests of society.

The tenant system undermines private property in land. We have taken it for granted that no one can make better use of the land than the owner himself, but this assumption loses all sense when the owner shifts the work of cultivation upon some one else. The landlord who uses the land as a means of living in idleness is ill-suited for the social mission assigned to him.

The separation of the rôles of landowner and farmer is disastrous to agriculture. The former often lives far away from the land and sometimes knows nothing about it; the latter merely hires it for a time and does not care what ultimately becomes of it.

The arguments presented in favour of the tenant system are these :—

(1) The system constitutes a division of labour. "The landlord," says Professor Leroy-Beaulieu, "stands for the future and permanent interests of the farm, whereas the tenant considers its present and temporary interests."

But these interests may conflict with each other ; hence it would be better that both interests be in care of the same person.

(2) To forbid leasing land to tenants would compel many owners to sell their estates.

This may be true. Yet if these persons cannot properly perform their function as landowners let them cease to be landowners. A function that is so important for the welfare of society must not be leased or delegated.

VI. Plans for Nationalizing the Land

Various plans are suggested for reforming the institution of property in land, in the interests of society as a whole. The following are the most important of them :—

(1) The government should buy the land and lease it to individuals for cultivation, in the same manner that it grants franchises to railroad companies. After the lapse of the period fixed the government could lease the land for a new period. Thus the State would receive all the unearned increment and collect an enormous revenue that would ultimately permit the abolition of all taxes.

But if the present owners of land are to be paid equitable prices, the State must incur an expense which would be ruinous.

(2) *Single tax system.* This system was ad

vocated by Mill. It has acquired widespread celebrity since its advocacy by Henry George. It consists in levying an increasing tax on land values, so as to absorb the whole unearned increment. Mr. George holds that this single tax would yield more than enough to support the Government and would make all other taxation unnecessary.

The great objection to this plan is that there are usually two elements in the increased value of land. The labour and capital of the landowner have often contributed much to the increased value of land. How is a public officer to ascertain the increase due to social causes. Again, if society profits by all gains in the value of land due to social causes, it is bound in equity to make good all losses arising from the decreased value due to social causes.

Finally, confiscation of rent by taxation would have the same effect as the confiscation of land itself. It would destroy the value of land as such and give rise to the necessity of paying an indemnity to the present holders.

Land nationalization seems to be impossible so far as it concerns property already established. With regard to future property, the Government could retain the proprietorship and merely grant leases to cultivators.

VII. The Subdivision of Property in Land

Social evolution, by which property in land tends to resemble property in capital, naturally diminishes the evils of the individual ownership of land.

It facilitates the division of land. What danger can there be in a monopoly when millions of men share in it?

It facilitates the transferability of land, thus

depriving the unearned value of the land of the character of a perpetual and increasing advantage.

These forces are economic. But legislative bodies are certainly able to exert great influence, either favourably or unfavourably. In old countries protection against the competition of foreign soils would aggravate the monopolistic character of land-ownership. Again, the laws of inheritance are potent factors for good or for evil. Owing to such devices as the right of primogeniture, the right of entail, and the countless expenditures and formalities attending the transfer of land, landed property appears nowhere more odious than in Great Britain.

In France the law requires that estates shall be divided equally among all the children of the deceased parents. This system carries the partition of estates far beyond the limits compatible with good husbandry.

CHAPTER IV— PROFITS

I. The Nature and Definition of Profits

THE share of the entrepreneur is called *profits*. Three explanations of the part played by the entrepreneur and of the essential nature of profits may be distinguished :—

(1) English economists have usually regarded the entrepreneur and the capitalist as identical, and have designated both by the latter name. They have regarded profits as a capitalistic income, analogous to interest, but fixed at a somewhat higher level.

It must be admitted that this way of looking at things seems quite in conformity with facts. In practice the rate of profit goes hand in hand with the rate of interest, and is calculated in the same way, viz., as a certain per cent. of the capital employed. This interpretation, however, must be abandoned. The part of the entrepreneur and that of the capitalist are distinct in theory, and sometimes in practice.

(2) French economists clearly separated these two parts. In their opinion the predominant characteristic of the entrepreneur is the performance of a certain kind of labour. Profits are the remuneration of labour, but of a particular kind of labour, consisting of the following elements :—

(a) *Invention*. The truly productive act is thought. The entrepreneur must have business

ideas. He must discover what will please the public, and must invent new wants.

(b) *Superintendence*. Collective labour is more productive than isolated labour, but there must be somebody to divide the work and give every labourer his proper place. This is the part of the entrepreneur, and for this reason he is called the captain of industry. Business, in fact, is much like war—the commander-in-chief wins or loses the battle.

(c) *Commercial speculation*. It is no difficult matter to produce goods ; the great problem is to sell them. The art of buying and selling on the most favourable terms is one of the principal accomplishments of the successful entrepreneur.

There is much truth in this theory, but it does not set forth the essential nature of profits. The function of the entrepreneur may be performed by hired employees. As a matter of fact, all large enterprises organized as companies employ men to perform the several tasks of the so-called entrepreneur.

(3) A great many economists consider the entrepreneur as possessing a monopoly. Profits are a monopolistic income, or so-called monopoly surplus. This monopoly may result from personal abilities, or from certain advantages of situation or opportunity.

This theory is most consistent with facts. It explains why the entrepreneur generally happens to be a capitalist. It also explains why exceptional personal qualities may be a source of large profits.

II. The Laws which determine Profits

If V represents the value of the finished product, W the wages, I the interest he must pay if he has borrowed all or part of his capital, then P the profit would be determined by this simple formula :—

$$P = V - (W + I).$$

Yet several elements are missing from this formula. The entrepreneur often has to rent land. Should not this rent be included in the cost of production? The economists of the English school answer that the rent of land is never a part of the cost of production, because it is the cost of production which determines rent. But this doctrine is too absolute. In all cases where rent is the price of a genuine monopoly—such as buildings and lands situated in cities—it is certainly part of the cost. Even if the entrepreneur furnish such land, there is no reason why rent should not form part of the cost of production. Again, the entrepreneur supplies a part of the capital and the labour of superintendence. It is clear that the interest on this capital and the wages for this labour should be reckoned a part of the cost of production. What remains after deducting all these elements is profit. But in many cases nothing remains. It is inevitable and just—inevitable because free competition is likely to keep the value of the finished products on a level with the cost of production, and just because, when the entrepreneur has received remuneration for the elements mentioned above, he cannot properly claim more.

III. The Legitimacy of Profits

The entrepreneur has been the principal target of socialistic attacks. But the socialistic objections to the entrepreneur were vague until the publication of Marx's book on Capital. The comparison established by some economists between the entrepreneur and the labourer, says Marx, is absurd. There was a time when the employer worked side by side with the workman, but under the present system of large-

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scale production the employer is exclusively a capitalist. He derives profit from buying and selling. He buys the productive power of the workman, known as labour. He sells the same power transformed and made concrete in the shape of commodities. The difference between the two constitutes his profit. The value of the product offered for sale is determined by the labour which it cost to produce them. But the entrepreneur pays the workman a sum necessary to support the workman and to keep him fit for work. The employer's profit, therefore, is a certain amount of unpaid labour. The value produced by the labourer is greater than the value required to support him.

This elaborate argument, designed to prove that profit is based on spoliation and cannot exist otherwise, is founded on the assumption that the value of manual labour is determined solely by the cost of production. If we refuse to accept this fundamental assumption as true, the whole structure erected upon it collapses. We have seen that in all cases value is determined by various causes.

In spite of this, there is much truth in the contention that labour has been treated as a commodity. Employers have, as a matter of fact, tried to obtain labour as cheaply as possible. It should not be forgotten, however, that nowadays trades unions, labour laws, co-operation, &c., tend to regulate the rate of wages by other laws than those which govern the price of commodities.

Nevertheless, while insisting that profits are not necessarily illegitimate, we may raise the question whether the office of the entrepreneur is an indispensable and permanent one. There are even now many successful stock companies which appear to get along without an entrepreneur. The place of

the individual employer is taken by a multitude of idle stock-holders. If we do away with these stock-holders as well, the enterprise will continue precisely as before.

Such are the views of the collectivists, but they seem to be illusory for the following reasons:—

(1) All stock companies were originally founded by private individuals, and nearly all of them are still managed financially by one leading shareholder, who is really an entrepreneur.

(2) In stock companies the absence of an employer is really the cause of a marked inferiority, and involves disadvantages resembling those that are inherent in public administration.

Economic evolution seems to point to the ultimate elimination of the class of employers, but the time does not yet seem ripe for accomplishing this step. We find sufficient proof for this in the difficulties experienced by co-operative societies for production. It should be noted in conclusion that there is a general tendency to exaggerate the rate of profits. If all the employers were done away with, and their profits divided among all the labourers, the latter would be surprised to discover how small an increase of their incomes would be the result of this expropriation.

IV. Profit-Sharing

We have seen that the wage system has some inherent evils. Under the existing economic organization of society, employers and workmen constitute two separate groups facing each other in an attitude of mutual opposition, yet each unable to proceed without the other. Moreover, the labourer is confined to a purely passive part, and has no

direct interest in the success or failure of the enterprise with which he is connected.

Profit-sharing is that method of remunerating labour which aims to do away with the disadvantages of the wage-system by making the labourer a kind of partner with the employer. The workmen thus receive an addition to their regular wages if the enterprise has been successful. The name "profit-sharing" is applied to those cases in which it is not simply a spontaneous gift on the part of the employer, but a contractual arrangement. The shares given to the labourers may either be paid to them in money or placed to their credit in a savings bank or insurance association. In France, where profit-sharing seems to be most successful, the latter method prevails.

The objects of profit-sharing are as follows :

- (1) To reconcile labour and capital.
- (2) To increase the productivity of labour by stimulating the workman's activity.
- (3) To increase the labourer's income.
- (4) To avoid loss of employment.

The system has met with little encouragement either from socialists or from conservative economists. Socialists regard profits as a robbery. They are not satisfied with the restitution of a part to the labourers. Conservative economists hesitate to acknowledge the utility of profit-sharing. Professor Leroy-Beaulieu ironically declares that labourers have no right to a share in the profits, inasmuch as profits are exclusively the result of the entrepreneur's management.

But if we maintain that profits are generally the result of a monopoly-element of some sort, it is only just that the labourers should participate in the advantages due to a monopoly which is useless without

their help. Profits are due much less to the work of the share-holding capitalists than to that of the employees. If the former are supposed to be fully entitled to a proportionate part of the proceeds of an enterprise, why not the latter?

It is argued that profit-sharing is unjust because employees do not share the losses. This argument is not conclusive. If there are losses the labourers will receive no profits. As for the wages, the labourers have as much right to them as the capitalists have to the stipulated interest. If the enterprise fails the capitalist loses his capital. The labourer has no capital to lose, but he loses his place.

Profit-sharing may be transformed into the quasi-partnership of labour and capital by making the labourer a shareholder. This more radical variety of profit-sharing is sometimes called *industrial co-partnership or labour co-partnership*.

V. Productive Co-operation

Productive Co-operation is a still more radical scheme. It contemplates the gradual disappearance of the employer. The industrial co-partnership may be regarded as the transition stage between the two systems. But societies for productive co-operation may also be formed without passing through these transitional stages. France is regarded as the classic land of institutes of this nature.

The obstacles encountered by these societies are numerous :—

(1) The greatest obstacle consists in the lack of economic education among the working classes.

(2) The second drawback is the want of capital. However, carefully organized associations would be able to borrow capital.

(3) The third danger is that they tend to re-establish the very institutions which they seek to eliminate, namely, the class of employers and the wage system. These associations have a tendency to become nothing more than joint-stock companies.

Yet there is reason to hope that these obstacles may be avoided by first traversing a stage of preparation. This preparation could be provided in these ways : (1) by profit-sharing, (2) by trades unions, (3) by consumers' co-operative societies.

It is by the last-named method that productive co-operation may achieve greater successes in future. In this connection it is important to note the difference between the federalistic and the individualistic system.

Under the federalistic system, consumer's co-operative societies establish workshops or factories for producing some of the articles they require. The labourers in their employ are simply wage-earners, and have no share in the profits. There has been much opposition to this system, on the ground that labourers should have a share both in the profits and in the ownership.

Under the individualistic system, which may be called *the autonomous system*, the labourers form independent productive societies ; the consumers' societies provide a market, and protect them from competition.

BOOK V.—CONSUMPTION

I. The Nature and Laws of Consumption

TO consume wealth is to utilize it for the satisfaction of our wants. *Consumption* is the ultimate aim of all economic activity. Logically, then, economics should begin with the study of consumption. The tendency of modern economic theory is to give greater importance to consumption. The Austrian school studies consumption and value from the standpoint of final utility, and emphasizes the principle that in consumption of wealth the maximum of gratification is reached when the final utilities of the last increments consumed are equal. Everybody, consciously or unconsciously, employs his income according to this law.

Two fundamental principles may be deduced concerning the order and quantities in which goods will be consumed : (1) We shall first procure goods which yield the greatest surplus of utility over cost. (2) We shall endeavour to reach a maximum of gratification by making the final utilities of the last increments of all commodities as nearly equal as possible.

Some authorities deny that it is possible to express such subjective matters as desire and utility in quantitative terms. Moreover, men are not so much creatures of reason as of habit and impulse.

Wants are often aroused by advertisements and show-windows.

Yet it must be pointed out that there is a striking uniformity in the habits of consumption of large classes of people.. The inferences drawn by Dr. Engel are as follows :—

(1) As the income of a family increases, a smaller percentage is spent on food, while the percentage of expenditure for clothing, rent, fuel, and light is nearly the same.

(2) A constantly growing percentage is expended for education, health, recreation, &c., as the income increases.

It must not be supposed that consumption necessarily implies destruction. On the other hand, we must not confound consumption with production. The consumption of raw materials involved in production is generally designated *reproductive consumption* to distinguish it from that which serves for the direct satisfaction of our wants, and which is called *unproductive consumption*. But only the latter is consumption proper, and the term should be confined to it.

Consumption is of two kinds :—

First, it is direct or immediate. It satisfies present wants and is effected by spending.

Secondly, it is postponed. It is intended to provide for future wants, and this is done by saving.

We shall examine both these presently. But before doing so, we must say a word about another celebrated problem due to the circumstance that the need of food involves the destruction of wealth.

II. Whether Production will always keep Pace with Consumption

Malthus affirmed that *the population tends to increase more rapidly than the means of subsistence*. He declared that production would always lag behind the demands of consumption. In an illustration he says that the population increases in a geometrical progression, while the food supply increases in an arithmetical progression. The equilibrium could be brought about only by a frequent reduction of population, effected by means of wars, epidemics, famines, &c. To make these immediate checks upon population unnecessary Malthus recommends a moral restraint.

A century has elapsed since the publication of this remarkable doctrine, and experience has not yet justified the prophecies of its author. To-day our principal anxiety is of quite the inverse nature. All speculations concerning the economic future of mankind can have little scientific value. Yet the following considerations may be noted:—

(1) The birth-rate tends to decrease with the growth of prosperity.

(2) The birth-rate is lower in democratic communities than in others.

(3) It is reasonable to hope that the fecundity of the human race will diminish in proportion to the moral and intellectual development of individuals.

CHAPTER I—SPENDING

I. Whether Spending helps Business

CERTAINLY money that is spent benefits those who receive it. It enables them to continue and expand their business. But we are mistaken when we believe :—

(1) That because spending encourages production, spending is more useful than saving. Money that is saved is always ultimately spent for some purpose. Instead of being spent by its owner, it is perhaps spent by the borrowers. Such a fallacy is due to the fact that consumption is the purpose of production. When men cease to consume they will cease to produce. But to argue, therefore, that consumption is the efficient cause of production is an absurdity.

(2) That spending is always an advantage, even though it involve the useless destruction of wealth. This popular misconception is defended by the assertion that the necessity of replacing the wealth destroyed furnishes additional work for labourers and capitalists. But the money would have been used, in any case. If the argument is based on sound reasoning, we must regret that things are not destroyed ten times as quickly and easily as they are.

II. Luxury

In its ordinary use the word *luxury* means the gratification of a superfluous want. This definition

does not imply the condemnation of luxury. When it degenerates into wastefulness it is condemnable. Public opinion measures wastefulness by the amount spent. The sole criterion of society is not the amount spent but the quantity of wealth or labour consumed in the satisfaction of a given want. The desire for flowers is certainly a luxury, but it is a charming, elevating luxury. When, however, we decorate our drawing-rooms with orchids brought from distant lands at the expense of hundreds of pounds, and perhaps at the cost of human life, this kind of luxury falls under the second definition. The consumer of the luxury does not contribute to social progress. It must not be supposed that the deplorable effects of this kind of luxury are imputable only to the rich. The sums that the poor spend daily for drink amount to much more than the value of the pearl which Cleopatra threw into her wine-cup.

III. Consumers' Associations

There are various devices for lowering the expenditure without reducing the quantity or lowering the quality of the objects consumed. The following are some of them:—

(1) *The common household*. Grouping several families together effects a great saving, but unfortunately it destroys home life.

(2) *Purchase in common*. Many advantages of living together may be realized by co-operative associations in which a number of persons unite to make their purchases jointly. More than one-fifth of the whole British population now purchases its goods in part or entirely at the stores of such associations. Co-operative consumption (or, as it is sometimes called, distributive co-operation) is

carried on in many other countries, but on a smaller scale than in Great Britain.

Most consumers' associations are characterized by these features : (1) sales for cash, (2) sales at the customary retail price, (3) distribution of profits among members according to the amount of purchases, (4) the use of certain parts of the profits for social and educational purposes.

The advantages of these associations are as follows :—

- (1) An economy in the cost of living.
- (2) A check on the adulteration of goods.
- (3) Abolition of advertising.

Should this movement continue to develop in future, the following will be its ultimate effects .

- (1) The elimination of business intermediaries.
- (2) A decrease in the number of individual concerns to the extent that these societies devote themselves to production.
- (3) A decrease in the number of large fortunes, and an increase in the number of small ones.
- (4) The perfect adjustment of production and distribution and the suppression of crises.

IV. The Cost of Housing

In modern times the economic conditions of life compel men to agglomerate in large cities. This tendency toward centralization has caused a steady increase in the rent of houses. Cheap and rapid local transportation has a tendency, however, to lead people to choose homes in the suburban districts. Meanwhile, another remedy consists in the construction of houses built to be rented to workmen. This can be brought about in various ways.

V. Absenteeism

The term *absenteeism* is used to designate the custom among wealthy property-owners of living abroad, or at least away from their estates. From the moral point of view, it is severely condemned. As regards landed proprietors, the condemnation is well founded. Their social function cannot properly be performed by proxy. In the case of capitalists it is otherwise. A certain degree of cosmopolitanism is quite useful in helping them to invest money most intelligently.

From the purely economic point of view absenteeism is condemned because the man who spends his money away from home does not enable his neighbours to profit by his expenditure, but helps strangers to profit thereby.

CHAPTER II—SAVING

I. The Conditions Necessary for Saving

SAVING is really postponed consumption. In ordinary speech saving is generally allied with investment. But the two acts are entirely distinct. Several conditions must be fulfilled before saving can take place.

(1) As a subjective condition to saving there must be a certain degree of foresight.

(2) As an objective condition to saving, it must be possible to preserve the commodity saved. The invention of money facilitated saving and made possible the marvellous enterprises of modern times.

(3) Before a man can save, his labour must yield more than the necessities of life.

(4) There must be institutions for facilitating saving. Modern society has created various such institutions.

II. Institutions to Facilitate Saving

(1) The best known of these institutions are savings-banks.

(2) Mutual provident societies consist of persons paying monthly dues ; at the end of a certain period the accumulated capital is divided among the members.

(3) Consumers' co-operative societies. These societies make saving automatic and unconscious.

(4) Co-operative credit societies, which are

simply popular banks, serve quite as well for saving money as for lending it.

III. The Social Utility of Saving

Saving possesses as a whole the same utility for society as for individuals: it provides for future wants. No progressive nation can do without it. It is the duty of all those who can save, to do so. Particularly it devolves upon the rich to save because they can do it most readily. The advice to the poor to save is not always justified. Whenever saving involves a curtailment of the necessary wants of men, the effect is rather bad than good. Use of alcohol and tobacco, to be sure, should be discouraged, as the sums used for these purposes could be better employed.

Much the same advice may be given to the rich. It should be remembered, moreover, that apart from personal expenditures there are other socially important and useful ways of spending money.

IV. Investment

Investment presupposes saving. But saving and investing are quite distinct. To save is to postpone consumption. To invest is to transfer to another one's power to consume. Investment is not an act of consumption, but of production.

There was a time when investment was difficult for two reasons:—

- (1) Because there was no opportunity to invest.
- (2) Because there was no security.

The social usefulness of investment is incontestable. Yet the man who invests is sometimes quite as much the object of popular animadversion as the man who hoards.

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